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No. _____

Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1993

NINTENDO OF AMERICA INC.,

Petitioner,

v.

LEWIS GALOOB TOYS, INC.,

Respondent.

Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

As the price of obtaining a restraining order or preliminary injunction, a litigant must post security from which its opponent may recover costs and damages if the latter is subsequently found to have been "wrongfully" enjoined or restrained. Fed. R. Civ. P. 65(c).

The circuit courts of appeals have employed three different standards in deciding when the enjoined party is entitled to recover damages from an injunction bond. The Court of Appeals for the Ninth Circuit has now created a four-way conflict among the federal circuits concerning the meaning of "wrongfully."

The Ninth Circuit held in this case that the enjoined party is always entitled to execution on the security unless it has been guilty of intentional deception or misconduct. In sharp contrast, the Fifth, Seventh, Tenth, Eleventh, District of Columbia, and Federal Circuits hold that a range of equitable factors, such as the enjoined party's failure to mitigate damages, are to be considered. These circuits differ sufficiently on the extent of allowable judicial discretion that they may be characterized as in conflict on that issue. Yet a fourth position, one of strict or automatic liability, has been adopted by the Second and, perhaps, the Third Circuits, so that an enjoined party that later wins the case is conclusively proved to have been wrongfully enjoined.

Two questions are presented:

1. Which of the four conflicting rules devised by the courts of appeals should govern exoneration of or

execution on security posted to obtain a preliminary injunction or restraining order?

2. On the undisputed facts of this case, where respondent did not even try to mitigate damages, was petitioner entitled, as a matter of law, to exoneration of its bond?

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Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

PETITION FOR A WRIT OF CERTIORARI

Petitioner, Nintendo of America Inc.,[1] petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit.

[1] All parties who appeared below are listed in the above caption. Pursuant to Rule 29.1 of the Rules of this Court, petitioner Nintendo of America Inc. states that it is a wholly-owned subsidiary of Nintendo Co., Ltd., a Japanese corporation. Nintendo of America Inc. has no subsidiaries that are not wholly-owned.

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 16 F.3d 1032 (9th Cir. 1994). The Court of Appeals denied a petition for rehearing and suggestion for rehearing en banc in an unreported order. The District Court opinion is unreported.[2]

JURISDICTION

The judgment of the Court of Appeals was entered on February 17, 1994. A timely petition for rehearing and suggestion for rehearing en banc were denied on March 21, 1994. This Court has jurisdiction to review the judgment of the Court of Appeals by writ of certiorari pursuant to 28 U.S.C. § 1254(1).

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[2] The opinion of the Court of Appeals is reprinted at pages A-1 to A-18 of the appendix to this brief. The order denying rehearing and rehearing en banc is reprinted at page A-19 of the appendix. Also contained in the appendix are the substantive decisions on the merits of the Ninth Circuit in *Lewis Galoob Toys, Inc. v. Nintendo of America Inc.*, 964 F.2d 965 (9th Cir. 1992), *cert. denied*, 113 S. Ct. 1582 (1993), reprinted at pages A-20 to A-35 of the appendix, and of the District Court, 780 F. Supp. 1283 (N.D. Cal. 1992), reprinted at pages A-36 to A-67 of the appendix. The Ninth Circuit's unpublished decision affirming the preliminary injunction is reprinted at pages A-68 to A-74 of the appendix.

STATUTORY PROVISION INVOLVED

This petition involves Federal Rule of Civil Procedure 65(c):

> **(c) Security.** No restraining order or preliminary injunction shall issue except upon the giving of security by the applicant, in such sum as the court deems proper, for the payment of such costs and damages as may be incurred or suffered by any party who is found to have been wrongfully enjoined or restrained. No such security shall be required of the United States or of an officer thereof.
>
> The provisions of Rule 65.1 apply to a surety upon a bond or undertaking under this rule.

STATEMENT OF THE CASE

This case presents a four-way conflict among the circuits on an important and recurring issue. The issue concerns litigants' rights to security posted in order to obtain a temporary injunction or restraining order when the party enjoined or restrained ultimately prevails in the lawsuit. The answer given will profoundly influence the course of thousands of litigations. If, as the court below held, the party preliminarily enjoined may automatically execute on the bond unless shown to have acted in bad faith, even litigants fully entitled to relief will be deterred from seeking temporary injunctions or restraining orders, and no party

enjoined or restrained will have any incentive to mitigate damages. The same result will follow if, as two courts of appeals have held, the right to execute is absolute. Very different consequences will follow if, as six courts of appeals have held, the right to execute is conditioned by equitable considerations such as the enjoined party's failure to mitigate damages. A uniform rule of decision is critical.

A. Statement of Facts

Petitioner, Nintendo of America Inc. ("Nintendo"), manufactures and sells a home video game system and video game cartridges. The audiovisual portions of the cartridges are protected by copyrights owned by Nintendo. Respondent, Lewis Galoob Toys, Inc. ("Galoob"), manufactures and sells a device, "Game Genie," which has the capacity of altering the games played on the Nintendo system and cartridges, *e.g.*, by making a video game character run faster or jump higher.

Galoob approached a well-known intellectual property law firm for advice as to whether Game Genie violated any of Nintendo's intellectual property rights. That firm prepared an opinion which suggested that the altered audiovisual works created by the Game Genie fit within the limited exception to a copyright owner's exclusive rights provided by Section 117 of the Copyright Act. 17 U.S.C. § 117 (Supp. 1992). *See* CR 315, Ex. B at 2-4.[3] Armed with this

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[3] Citations to "CR __" are to the Clerk's Records in the district court.

opinion, Galoob contacted Nintendo and inquired about obtaining a license for the Game Genie. Nintendo stated its view that Game Genie infringed Nintendo's copyrighted video game audiovisual works, which were not within the purview of Section 117, and advised Galoob that it would not grant a license.

B. Proceedings Below

On May 17, 1990, Galoob filed a complaint seeking a declaratory judgment that Game Genie did not violate any of Nintendo's video game copyrights. After commencement of Galoob's action, Nintendo filed this lawsuit alleging copyright infringement and sought temporary injunctive relief. In opposing such relief, Galoob admitted that the Game Genie created derivative works and relied on Section 117 of the Copyright Act as a basis for non-infringement. 6/8/90 RT at 5:5 - 6:3, 11:21-22, 12:3-17, 13:14-23 and 14:7-23; 6/29/90 RT at 18:4-23.[4]

Following a hearing, the district judge issued the temporary injunction, holding that, on the record presented, Nintendo was likely to prevail on the issue of copyright infringement. He found that Game Genie produces "what can only be termed [infringing] derivative works." 6/29/90 RT at 34:14 - 35:5. The judge rejected Galoob's Section 117

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[4] Citations to "RT __" are to the Reporter's Transcripts of the hearings in the district court.

defense, finding that Section 117, "by its plain language, does not apply to this situation." *Id.* at 35:6-11.[5]

Galoob retained new counsel, who filed an appeal based not only on the Section 117 defense but various new defenses including "fair use." Galoob also asserted for the first time that the Game Genie did not create infringing derivative works because the effects caused by Game Genie were allegedly not fixed in a tangible medium of expression and were not original. *See* CR 315 Ex. F at 17-19, 25-30. Although neither of these defenses had been raised below, Galoob argued to the Ninth Circuit, in a brief filed on August 10, 1990, that the record was fully developed for a reversal of the preliminary injunction based on these defenses. Galoob opening brief in Appeal No. CA 90-15936 at 16, n.9.

In a decision issued on January 24, 1991, the Ninth Circuit refused to consider the new defenses raised by Galoob, applying the established rule that "a federal appellate court will not review issues on appeal that were not raised in the Court below." (A-72) The Court also rejected Galoob's invitation to apply the "narrow and discretionary exception" permitting "consideration of issues of law that do not require factual determinations beyond those in the record." (*Id.*) The court refused to do so on the grounds, *inter alia*, that the new defense required findings of fact not made by the district court.

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[5] After the preliminary injunction was issued, the case was transferred to another district judge.

Despite this rejection, Galoob did not move in the district court to modify or dissolve the preliminary injunction and thereby obtain the findings of fact essential to its new defenses. Instead, while the action was proceeding toward trial, Galoob simply filed a series of motions to increase the preliminary injunction bond which Nintendo had posted pursuant to Fed. R. Civ. P. 65(c). Over Nintendo's opposition, the original bond of $100,000 was raised to $5 million and then to $15 million.

In ruling on Nintendo's copyright infringement claim after trial, the district court acknowledged that the issues presented were "difficult and novel." 7/3/91 RT at 4. *See also* A-49. Ultimately, however, the court accepted the contention of Galoob's new counsel that Game Genie did not create infringing derivative works and was a "fair use." (A-50 - 51) These were among the new defenses that the Ninth Circuit had refused to consider in its January 24, 1991 decision. Conversely, Galoob's defense at the preliminary injunction stage, Section 117, was expressly not reached by the court and formed no part of the decision on the merits. 7/3/91 RT at 13:13-16. The district court vacated the preliminary injunction on July 12, 1991.

Nintendo appealed the district court's determination of the copyright issues. The Ninth Circuit affirmed the district court's judgment. 964 F.2d 965 (9th Cir. 1992), *cert. denied*, 113 S. Ct. 1382 (1993).

On September 11, 1991, Nintendo filed a motion to exonerate the preliminary injunction bond on the grounds

that it was inappropriate and inequitable to impose liability on the bond in this case. Galoob cross-moved for execution on the bond. Without requiring Galoob to reply or allowing Nintendo to reply, the district court summarily denied Nintendo's motion and, after an expedited damages hearing, awarded the entire amount of the $15 million preliminary injunction bond to Galoob. CR 317.

The Ninth Circuit affirmed the award, 16 F.3d 1032 (9th Cir. 1994). The court held that a party is "wrongfully enjoined" under Rule 65(c) "when it turns out the party enjoined had the right all along to do what it was enjoined from doing." (A-11) The court then noted that "there appears to be some variance in how other circuits" determine when to allow a wrongfully enjoined party to execute a bond. (*Id.*) It decided to "join what appears to be the majority" and to find a "rebuttable presumption" in favor of execution. (A-12) The court then concluded that Nintendo had not rebutted this presumption because it had not shown that Galoob had engaged in deception or misconduct in opposing the request for injunctive relief. (A-14 - 15)

On March 21, 1994, the Ninth Circuit denied Nintendo's petition for rehearing and suggestion for rehearing en banc. (A-19)

REASONS FOR GRANTING THE PETITION

This case merits review because the Ninth Circuit has brought additional confusion to issues — in the application of Rule 65(c) — that have long been the subject of widely divergent analyses by courts and commentators.

> In all of the stages of the existing process of recovering on injunction bonds, courts have departed from or given conflicting interpretations of rule 65(c). They have thereby greatly decreased the value of the rule as a means of providing consistent guidelines: they have transformed the federal law of injunction bonds into "a field within which judicial judgment moves untrammeled by fixed principles." [Citing B. Cardozo, *The Nature of the Judicial Process* 128 (1921).] This state of the law has allowed, and continues to allow, unjust results.

Note, *Recovery For Wrongful Interlocutory Injunctions Under Rule 65(c)*, 99 Harv. L. Rev 828, 846 (1986).

The writ should issue for two reasons. *First*, although nominally adopting what it characterized as the "majority view" of the circuit courts, the Ninth Circuit's approach is, in fact, at odds with both versions of that view, as well as with the minority view, and creates yet a fourth standard that has not been recognized or applied by any other circuit. Confusion reigns and unjust results necessarily follow. A uniform interpretation of Rule 65(c), which only this Court can provide, is needed.

Second, the Ninth Circuit's error is a matter of great significance in the conduct of federal litigation. Interlocutory injunctions are an essential form of relief in many cases. It is important that parties not be deterred from seeking such relief by the prospect of losing substantial sums of money (here $15 million) should the injunction later be dissolved even though the enjoined party utterly failed to mitigate damages, as Galoob did here. It is equally important that the enjoined party who later prevails recover damages only where those damages are not traceable to its own conduct. Here, Galoob chose to present its new defenses for the first time on an appeal from the issuance of the temporary injunction rather than presenting them to the district court in a motion to modify or dissolve the injunction. That appeal stripped the district court of jurisdiction for seven months, during which damages accumulated. But even after its appeal had been denied, Galoob did not seek relief from the district court on the basis of its new defenses but kept obtaining increases in the amount of Nintendo's bond. Awarding execution on the bond despite Galoob's failure even to attempt to mitigate its damages produced not merely a palpably unjust result but a rule that seriously damages the utility of interlocutory injunctions.

I.

CERTIORARI SHOULD BE GRANTED TO RESOLVE THE CONFLICT AMONG THE CIRCUITS REGARDING THE STANDARD FOR EXECUTION ON SECURITY GIVEN TO OBTAIN A PRELIMINARY INJUNCTION OR RESTRAINING ORDER.

Rule 65(c) requires the provision of security as a condition of obtaining a preliminary injunction but addresses execution upon the security only by allowing recovery of damages and costs by a litigant who was "wrongfully" enjoined.

A clear majority of federal circuits require courts to exercise equitable discretion in allowing execution upon a bond. But there is a conflict between the circuits upon the extent of that discretion. Two circuits have taken the view that Rule 65(c) does not limit the broad discretion of the trial court, in the exercise of its equity powers, to avoid any injustice between the parties. *H&R Block, Inc. v. McCaslin*, 541 F.2d 1098 (5th Cir. 1976), *cert. denied*, 430 U.S. 946 (1977); *State of Kan. ex rel. Stephan v. Adams*, 705 F.2d 1267 (10th Cir. 1983).[6] In denying damage awards, these

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[6] The District of Columbia Circuit appeared to take a similar view in *Page Communications Engineers, Inc. v. Froehlke*, 475 F.2d 994 (D.C. Cir. 1973), but later made clear in *National Kidney Patients Ass'n v. Sullivan*, 985 F.2d 1127 (D.C. Cir. 1992), *cert. denied*, 113 S. Ct. 966 (1993), that it approved of *Coyne-Delaney v. Capital Devel. Bd.*, 717 F.2d 385 (7th Cir. 1983), and that *Page* would have come out the same way under

courts emphasized that the plaintiff had acted in good faith in seeking an injunction.

Other courts allowing equitable discretion disagreed with the broad exercise of discretion approved by the Fifth and Tenth Circuits and required more rigorous analysis. *Coyne-Delaney v. Capital Devel. Bd.*, 717 F.2d 385 (7th Cir. 1983), perhaps the most influential of the decisions in this group, affirmed the responsibility of courts to consider a range of equitable factors but cautioned that, if an award of damages is to be denied, the analysis of equitable factors must yield an objective "good reason" to do so. *See also State of Ala. ex rel. Siegelman v. U.S. E.P.A.*, 925 F.2d 385 (11th Cir. 1991); *Zenith Radio Corp. v. U.S.*, 823 F.2d 518 (Fed. Cir. 1987). The District of Columbia Circuit expressed agreement with *Coyne-Delaney* and stated that a successful defendant enjoys a "rebuttable presumption" of entitlement to damages. *National Kidney Patients Ass'n v. Sullivan*, 958 F.2d 1127 (D.C. Cir. 1992), *cert. denied*, 113 S. Ct. 966 (1993). These courts discounted the importance of good faith on the part of a plaintiff as a justification for denying the award of damages. Good faith, they reasoned, was to be expected and only its absence would be of particular significance.

Finally, at the other end of the spectrum, the Second Circuit, and perhaps the Third, adopted a position that left no discretion to the trial court, *i.e.*, assuming the only issue to be "whether, in hindsight in light of the ultimate decision

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that method of analysis.

on the merits after a full hearing, the injunction should not have issued in the first instance." *Blumenthal v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 910 F.2d 1049, 1054 (2d Cir. 1990); *American Bible Society v. Blount*, 446 F.2d 588, 595 n.12 (3d Cir. 1971).

In this case, the Ninth Circuit declined to impose absolute liability, as Galoob requested, and indicated that it would follow the majority view. In fact, however, the Ninth Circuit ignored the key element of the majority view that mandates consideration of the full range of relevant factors. On the contrary, it focused on a single issue: whether respondent Galoob had been guilty of intentional deception or misconduct in opposing, appealing from, and failing to seek the lifting of the preliminary injunction. Finding that Galoob was not guilty of such misconduct, the court of appeals upheld the district court's award of damages. (A-14)

The standard applied by the Ninth Circuit is so narrow and restrictive as to be of little practical value; indeed, it will usually produce the results of the minority strict-liability rule. Ironically, as a majority of the circuits decided that a plaintiff's good faith was not sufficient reason to deny an award of damages, the Ninth Circuit decided that a defendant's good faith was sufficient reason to award damages. By doing so, the Ninth Circuit effectively created a dual standard for plaintiffs and defendants, one comparable to the dual standard recently rejected by this Court in another copyright action. *Fogerty v. Fantasy, Inc.*, 114 S. Ct. 1023 (1994). Moreover, any approach that turns entirely on the absence of bad faith, whether on the part of the

plaintiff or the defendant, is sure to produce unjust results by foreclosing examination of other obviously relevant factors. One of those factors is certainly the defendant's failure to mitigate damages when that could easily have been done.

An examination of the relevant factors in the present case will demonstrate that there was indeed "good reason" to eliminate or, at a minimum, greatly reduce, the award of damages to Galoob. Apart from demonstrating the gross inequity of the result here, such an examination will point up the grave risk to future plaintiffs if the unique standard created by the Ninth Circuit is not rejected along with the automatic damages standard of the Second and Third Circuits.

A. Upon An Application For Execution On Security Pursuant to Rule 65(c), The Court Should Consider All Relevant Factors To Determine Whether There Is A Good Reason To Deny or Reduce The Award of Damages

In *Page v. Froehlke*, *supra*, the court faced a situation identical in its equities to the present case. The court held that it was "bound to effect justice between the parties, avoiding any result that would be inequitable or oppressive for either party." 475 F.2d at 997. The court then exonerated the plaintiff from liability on a preliminary injunction bond on the ground that the defendant had in its possession, but did not produce at the preliminary injunction hearing, a pertinent document. The court observed that "the injunction might not have issued if the [defendant] had

timely filed the comparative cost study, an important and relevant document." *Id.* at 997.

In *National Kidney Patients Ass'n v. Sullivan*, *supra*, the District of Columbia Circuit, in discussing its earlier decision in *Page v. Froehlke*, pointed out that the failure of the defendant to have produced the comparative cost study at the preliminary injunction hearing was comparable to a failure to mitigate damages which *Coyne-Delaney* had said was a "good reason" for not allowing the enjoined party to recover damages under the bond. 958 F.2d at 1134.

In *Coyne-Delaney v. Capital Devel. Bd.*, *supra*, the Seventh Circuit held that damages should be awarded pursuant to Rule 65(c) unless there appeared to be a "good reason" not to do so. Nevertheless, the Court was at pains to emphasize the duty of the trial court "to consider the full range of factors relevant under that standard." 717 F.2d at 392. In particular, the court emphasized that:

> A good reason for not awarding such damages would be that the defendant has failed to mitigate damages. *Id.*

The court also pointed out that a change in the applicable law, subsequent to the preliminary injunction hearing, was a "legitimate consideration" in the determination of whether to award damages. *Id.*

The Seventh Circuit was careful to point out that the test to be applied was not the judge's unguided, subjective sense of fairness. Instead, "the ingredients of a proper

decision are objective factors . . . accessible to the judgment of a reviewing court." *Id.* The court reversed the denial of damages by the district court and remanded the case for a reevaluation of the equities.

This case is strikingly similar to the facts and rationale of *Page* and to *Coyne-Delaney's* reasoning. Here, much as in *Page*, Galoob withheld its real defenses from the district court until trial on the merits. The district court had no occasion to consider the legal defenses that ultimately prevailed at trial. Galoob's decision not to present those arguments was also a plain failure even to attempt to mitigate damages within the meaning of *Coyne-Delaney*.

Subsequent cases were similarly explicit in their insistence upon a careful examination by the trial court of all relevant factors. For example, in *Zenith Radio Corp.*, *supra*, the Federal Circuit upheld a decision of the Court of International Trade to deny damages on the basis of five "equitable factors" including a change in the law that had deprived the trial court of jurisdiction over the plaintiff's claim. In *State of Ala. ex rel. Siegelman v. U.S. E.P.A.*, *supra*, the Eleventh Circuit held that the equitable factors considered by the district court did not justify a refusal to award *any* damages but should be considered in determining the *amount* of an award.

In short, the "majority view" identified by the Ninth Circuit carries with it not only a presumption favoring the award of damages but a clear mandate for a thorough examination of all relevant factors to determine whether

equity requires that the award be denied or reduced. As will be shown below, it is precisely such an examination that the district court and the Ninth Circuit failed to make.

B. The Erroneous Standard Applied By The Ninth Circuit Rejected Any Consideration Of The Equitable Factors Emphasized By The Large Majority Of The Circuits.

Nintendo's appeal to the Ninth Circuit stressed that the procedural history of the case made the award of damages to Galoob grossly inequitable. Indeed, the record demonstrated that any damages sustained by Galoob were the product of its own reappraisal of the substantive law, procedural misjudgment, and tactical decision. Most important, Galoob steadfastly refused to take any step to mitigate its damages by bringing its new defenses to the attention of the trial court.

Galoob had and took a full opportunity, after Nintendo rejected its request for a license, to study the legality of its Game Genie device before it initiated its action. *See* CR 315, Ex. B at 2-4. With the full benefit of controlling the timing and place of the litigation, Galoob admitted at the preliminary injunction hearing that the Game Genie created derivative works and relied solely on Section 117 of the Copyright Act as a purported basis for non-infringement. 6/8/90 RT at 5:5 - 6:3, 11:21-22, 12:3-17, 13:14-23 and 14:7-23; 6/29/90 RT at 18:4-23.

After the hearing, the district court granted Nintendo's motion, finding that the Game Genie produces

"what can only be termed derivative works," rejecting Galoob's Section 117 defense, and finding a likelihood of Nintendo's succeeding on the merits. 6/29/90 RT at 34:14 - 35:11. In July 1990, the case was transferred to another judge, and Galoob retained new counsel. Galoob did not institute any action in the district court to seek relief from the injunction; instead, in August 1990, Galoob chose to file an appeal that raised a host of new defenses including the contentions that the Game Genie did not create derivative works and that it represented a "fair use" under the Copyright Act as a matter of law.

Galoob's decision to appeal the granting of the preliminary injunction, and not present its new defenses to the district court, was pivotal: because it deprived the district court of jurisdiction, the appeal would leave the injunction in effect for the next seven months. Galoob's counsel was not unaware of the rule against federal appellate review of issues not raised below but gambled that they could persuade the Ninth Circuit to make an exception to that rule. The Ninth Circuit declined and Galoob's gamble failed, to the injury, perversely enough, of Nintendo.

Even after the decision by the Ninth Circuit on January 24, 1991, Galoob declined to present its new defenses to the district court and to seek a dissolution of the preliminary injunction. On the contrary, Galoob elected to stand mute on the underlying issues while filing a series of successful motions over many months to increase Nintendo's bond from $100,000 to $15,000,000. *See* CR 48-52, CR 89-100.

The Ninth Circuit opinion on the award of damages under the injunction bond is devoid of any equitable analysis of this history. Rather, the court embarked on a search for evidence of bad faith or deceit on Galoob's part (A-14):

> Nintendo's argument that Galoob failed to assert all of its defenses at the time Nintendo sought the preliminary injunction raises the scepter [sic] of bad faith on the part of Galoob. The essence of this argument is that Galoob took advantage of Nintendo by initially making its case appear to be worse than it really was, thus lulling Nintendo into obtaining the preliminary injunction. The implication of the argument is that Galoob cunningly got the court to raise the amount of the bond on two successive occasions, finally pushing it up to $15 million, while concealing the hole cards it intended to play at the time of trial. Nintendo argues it would be inequitable to permit Galoob to recover damages when it pursued such wily litigation tactics. In support of the argument, Nintendo relies on *Page Communications Eng'rs, Inc. v. Froehlke*, 475 F.2d 994 (D.C. Cir. 1973).

The Ninth Circuit's analysis misread both *Page v. Froehlke* and Nintendo's argument. As previously indicated, *Page* did turn on the failure of the defendant to have produced an important document at the preliminary injunction hearing. And Nintendo did contend that *Page* presented a strong analogy to the present case. But *Page* did not involve — and Nintendo never claimed that it involved — any intentional misconduct on the part of the defendant.

On the contrary, in *Page* it was the fact that the document in question was not provided, not the bad faith of the enjoined party in failing to provide it, that required exoneration of the bond. The court recognized the importance of the fact that the district court did not have before it the complete picture of the case at the preliminary injunction stage because of the omission on the part of the enjoined party. Irrespective of whether that omission was accidental or intentional, *Page* held, consistent with the majority rule, that it would be "inequitable and a perversion of justice" to allow the enjoined party to execute on the bond. 475 F.2d at 997.

For its part, Nintendo specifically disclaimed that Galoob's subjective intent in withholding defenses was dispositive. *See* Nintendo's Reply Brief at 9-10. If the court had concluded that Galoob acted in bad faith, that should, of course, have been conclusive and required exoneration, just as bad faith on the part of Nintendo would have been conclusive in requiring execution.[7] Absent bad faith on the part of either party, however, the court was required to examine all of the equitable factors.

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[7]As the Ninth Circuit observed (A-13):

> [I]f a party obtains a preliminary injunction in bad faith, that party "flunks [the good faith test and] the presumption in favor of enforcement [of the bond] congeals virtually into a rock." *National Kidney*, 958 F.2d at 1135.

Contrary to the implication by the Ninth Circuit, Nintendo never argued that its good faith was an independent ground for exoneration. It merely pointed out that it has met that essential prerequisite.

The Ninth Circuit's preoccupation with bad faith led it to overlook or ignore the more obvious teachings of *Page* and other decisions reflecting the majority view. For example, as previously indicated, it is well recognized that a defendant's failure to mitigate its damages is grounds to deny or reduce an award. *Coyne-Delaney v. Capital Devel. Bd.*, 717 F.2d at 392; *National Kidney Patients Ass'n v. Sullivan*, 958 F.2d at 1134; Note, *Interlocutory Injunctions and the Injunction Bond*, 73 Harv. L. Rev. 333, 346 (1959) (the duty of mitigation means that the defendant "must move to dissolve the order as soon as possible").[8]

The present case presents a failure to mitigate that could hardly be clearer. Assuming that Galoob had not become aware of its defenses at the time of the preliminary injunction hearing — despite ample opportunity to have done so — it was demonstrably aware of them by August when they were raised in Galoob's brief to the Ninth Circuit. And even if one could somehow justify Galoob's decision to attempt to raise those defenses for the first time before the Ninth Circuit, the rejection of the defenses by the Ninth Circuit, because those defenses had not been urged below,

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[8] As this Court long ago held in the breach of contract context, if a party "can save himself from a loss arising from a breach of [contract] at a trifling expense or with reasonable exertions, it is his duty to do it, and he can charge the delinquent with such damages only as with reasonable endeavors and expense he could not prevent." *Warren v. Stoddart*, 105 U.S. 224 (1881). *See also Williston on Contracts* § 1039 (3d ed. 1967), regarding mitigation of damages.

made unmistakable Galoob's duty to present them to the district court.

Similarly, the Ninth Circuit failed to consider the importance given, under the majority view, to a change in the applicable law subsequent to the preliminary injunction hearing. See *Zenith Radio Corp.*, *supra*; *Coyne-Delaney v. Capital Devel. Bd.*, *supra*. In this case, Galoob effected a dramatic metamorphosis in the theories of its defense. That transformation in Galoob's view of what law controlled the case is closely analogous to a court decision or statute which altered the law after the issuance of a temporary injunction. Both types of changes must be brought to the attention of the district court. The "change in the law" applicable to Nintendo's claims led directly to Galoob's ultimate success. Such a change, effected by the defendant itself, merits even greater weight than a change imposed by a neutral third party, *i.e.*, a court or legislature.[9]

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[9] Compare the comment of Judge Posner in *Coyne-Delaney*, 717 F.2d at 392-93:

> We do not believe that a change in the law is always a good ground for denying costs and injunction damage to a prevailing party, but it is a legitimate consideration, perhaps especially where the prevailing party is a state agency that benefitted from a change in the law of its state. In a sense, this is a case where one state agency (the Board) is seeking to benefit from the confusing signal sent out by another state agency (the court system) — though we do not mean to suggest that the Illinois Supreme Court was rushing fraternally to the aid of another state agency when it reversed *Polyvend*.

In *Zenith Radio Corp.*, *supra*, the Federal Circuit upheld the denial of injunction bond damages where the "change in the law"

The standard for execution on an injunction bond badly requires clarification. Under the proper standard, failure to mitigate damages requires exoneration rather than execution.

II.

CERTIORARI SHOULD BE GRANTED BECAUSE THE CONSTRUCTION OF RULE 65(c) IS OF GREAT IMPORTANCE IN FEDERAL LITIGATION

If the unique approach of the Ninth Circuit is permitted to go uncorrected, or if the automatic liability rules of the Second and Third Circuits are allowed to stand, there will likely be adverse consequences far beyond those jurisdictions. Given the divergent views of the various circuits with respect to Rule 65(c), it clearly has the potential to influence, and distort, the law. The decision here, that all equitable factors other than the defendant's good faith are irrelevant, will, at a minimum, reinforce the minority view of strict liability espoused by the Second Circuit and, it appears, by the Third as well.

The importance of injunctive relief to the litigation process is beyond argument:

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was a ruling in another case, on an issue of first impression, that there was no jurisdiction to entertain Zenith's lawsuit. 823 F.2d at 520-21.

> Although the fundamental fairness of preventing irremediable harm to a party is an important factor on a preliminary injunction application, the most compelling reason in favor of [granting a preliminary injunction] is the need to prevent the judicial process from being rendered futile by defendant's action or refusal to act.

Canal Authority of State of Florida v. Callaway, 489 F.2d 567, 573 (5th Cir. 1974) (quoting Wright and Miller, *Federal Practice and Procedure: Civil* § 2947 (1973)) (alteration in original). It follows that imposition of undue or unwarranted burdens on the obtaining of an injunction threatens the very integrity of the process. Indeed, the avoidance of undue burdens made many courts at common law reluctant to require a bond in the first instance. *See* Note, *Interlocutory Injunctions and the Injunction Bond*, *supra* p. 20, at 336.[10] The requirement of a bond under the Federal Rule is now well settled.[11] Nevertheless, the

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[10] "The injunction bond appears to be the result of the interaction of two major competing considerations[:] . . . the traditional reluctance to penalize a plaintiff for resorting to the judicial process or to make him pay a price for his remedy [and] . . . the extreme caution which often permeates judicial proceedings and is reflected in their elaborate safeguards. . . ." *Id.*

[11] Under appropriate circumstances, the Federal requirement may be relaxed. *Wayne Chemical, Inc. v. Columbus Agency Service Corp.*, 567 F.2d 692, 701 (7th Cir. 1977) (in suit to enforce rights under a group medical policy, indigence of party excuses bond requirement); *Crowley v. Local No. 82*, 679 F.2d 978, 1000-01 (1982), *rev'd on other grounds*, 467 U.S. 526 (1984) (district court did not err in refusing to require union

avoidance of undue burdens must remain a matter of serious and legitimate concern.

The unfortunate consequence of imposing such a burden by adoption of either the Ninth Circuit's approach or the automatic liability view, may be felt in any of the myriad circumstances under which injunctive relief is sought. But nowhere is the potential harm more serious than in actions under the Copyright Law. Injunctive relief is vital to the protection of intellectual property. And the availability of preliminary relief is especially important. As Nintendo pointed out in its brief to the Ninth Circuit, the Copyright Law recognizes that importance by providing a presumption of irreparable injury to copyright owners who, in seeking preliminary relief, establish a likelihood of success on the merits. *See, e.g., Johnson Controls, Inc. v. Phoenix Control Systems, Inc.*, 886 F.2d 173, 1174 (9th Cir. 1989); *Apple Computer, Inc. v. Formula Int'l Inc.*, 725 F.2d 521 (9th Cir. 1984).[12]

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members to post bond where absence of security would not impose significant burden on defendants, plaintiffs were less able to afford security, and bond requirement would affect enforcement of statutory labor rights).

[12] Nintendo also noted that a copyright owner is generally entitled to an injunction to halt any infringement, citing *Universal City Studios, Inc. v. Sony Corp. of America*, 659 F.2d 963, 976 (9th Cir. 1981), *rev'd on other grounds*, 464 U.S. 417 (1984). The Ninth Circuit observed that *Universal City* had involved a permanent injunction and concluded that "public policy does not advocate the liberal issuance of *preliminary* injunctions in copyright infringement actions." 16 F.3d at 1038. The Court, however, was mistaken. As reflected by the authorities cited in the

In a field such as copyright law, where the governing legal principles are extraordinarily complex and frequently changing, the implications of the standard adopted by the Ninth Circuit are particularly disturbing. As interpreted by the Ninth Circuit, Rule 65(c) will go far beyond the rationale, adopted by the Ninth Circuit, of discouraging "flimsy claims." A copyright owner who furnishes security to obtain injunctive relief will know that he is at risk not only from defenses presented at the preliminary injunction stage but from any defense that later occurs to the alleged infringer at any time prior to, or perhaps even during, the trial. Such a standard, we submit, can only have a chilling effect upon bona fide efforts of copyright owners to protect the fruits of their creative labors.

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text, an application for preliminary relief, like an application for permanent relief, will be granted upon a showing of infringement, *i.e.*, because of public policy considerations, the element of irreparable injury need not be demonstrated.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Dated: June 17, 1994

Respectfully submitted,

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UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

NINTENDO OF AMERICA, INC.,
Plaintiff-Appellant,

v.

LEWIS GALOOB TOYS, INC.,
Defendant-Appellee.

No. 92-16364

D.C. No.
CV-90-01440-FMS

OPINION

Appeal from the United States District Court
for the Northern District of California
Fern M. Smith, District Judge, Presiding

Argued and Submitted
December 14, 1993—San Francisco, California

Filed February 17, 1994

Before: Donald P. Lay*, Cynthia Holcomb Hall and
David R. Thompson, Circuit Judges.

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* Hon. Donald P. Lay, Senior Circuit Judge for the Eighth Circuit, sitting by designation.

Opinion by Judge Thompson

SUMMARY

Civil Litigation and Procedure/Interim Relief — Preliminary Injunctions/Interim Relief

The court of appeals affirmed a district court judgment. The court held that a defendant who was wrongfully enjoined was entitled to have the full amount of the injunction bond executed in its favor.

Several years after appellant Nintendo of America, Inc. began selling a home video game system called the Nintendo Entertainment System (NES), appellee Lewis Galoob Toys, Inc. announced its intention to begin selling the Game Genie, an electronic device allowing NES owners to change aspects of NES video games. A month later, Nintendo brought a copyright infringement action against Galoob. Nintendo obtained a preliminary injunction against the sale of the Game Genie. The district court required Nintendo to post a $15 million bond as security for the injunction.

At trial, Galoob asserted additional legal theories that it had not asserted at the preliminary injunction hearing. Galoob prevailed at trial, and the district court vacated the injunction.

The district court held a "lost sales" hearing to determine the number of Game Genie sales Galoob lost because of the injunction. Galoob's evidence included a comparison of the Game Genie to another NES accessory, the Nintendo Advantage, for

which sales figures were available. The court, assuming that the Game Genie was at least as attractive to NES owners as was the Nintendo Advantage, determined that Galoob lost 1.6 million Game Genie sales due to the injunction. The district court also held a "profits hearing" to determine Galoob's net profit margin. Galoob called an economist who testified regarding its profit margin. The district court awarded Galoob the entire amount of the bond after finding that the injunction caused Galoob at least $15 million in damages. Nintendo appealed.

[1] A party has been wrongfully enjoined when it turns out that the party enjoined had the right all along to do what it was enjoined from doing. **[2]** In this case, Galoob was wrongfully enjoined.

[3] There is a rebuttable presumption that a wrongfully enjoined party is entitled to have the bond executed and recover provable damages up to the amount of the bond. **[4]** Galoob's litigation conduct did not preclude it from recovering on the bond. There was no indication in the record that Galoob sandbagged Nintendo into prevailing on its application for the preliminary injunction, knowing all the while that it could have defeated that application.

[5] Galoob established with reasonable certainty that it was damaged by the issuance of the injunction. **[6]** The district court's method of calculating the number of lost sales was not erroneous; the court repeatedly used the most conservative ends of available ranges in calculating the number. **[7]** Thus, Galoob was entitled to have the full amount of the bond executed in its favor.

COUNSEL

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OPINION

THOMPSON, Circuit Judge:

Nintendo of America, Inc. appeals the execution of a $15 million bond in favor of Lewis Galoob Toys, Inc. Nintendo posted the bond as security for a preliminary injunction against Galoob in a copyright infringement action Nintendo later lost. The district court awarded Galoob the entire amount of the bond after finding the injunction caused Galoob at least $15 million in damages.

Nintendo argues the district court erred in three ways: First, by not weighing equitable considerations before deciding to execute the bond; second, by improperly finding the injunction harmed Galoob; and third, by improperly calculating the amount of Galoob's damages.

We have jurisdiction under 28 U.S.C. § 1291, and we affirm.

FACTS

The Nintendo Entertainment System ("NES") was the most popular home video game system in the United States from the late 1980s until the early 1990s. Its manufacturer, Nintendo of America, Inc., began selling the NES in 1986. By 1991 Nintendo had sold over thirty million units in the United States.

Several years after Nintendo introduced the NES, Lewis Galoob Toys, Inc. announced its intention to begin selling the Game Genie, an electronic device allowing NES owners to change aspects of NES video games. For example, the Game Genie would permit a video game character to run faster, jump higher, or become immortal.

At the time of Galoob's announcement of the Game Genie, in May 1990, NES product sales were at or near their peak. Nintendo sold nearly fifteen million NES video games that year, exceeding any other year's sales. Consumer interest in the Game Genie was similarly intense. Immediately after the product announcement, Galoob received orders for over 550,000 Game Genies, and expected to sell well over a million units in 1990. Expert witnesses later testified Galoob could have sold as many as 6.5 million units over the product's lifetime.

Only one month after Galoob's announcement, however, Nintendo obtained a preliminary injunction against the sale of the Game Genie. Nintendo's lawsuit and request for a preliminary injunction responded to an earlier lawsuit filed by Galoob in which Galoob sought a declaratory judgment that its Game Genie did not violate any of Nintendo's intellectual property rights.

At the hearing for the preliminary injunction, Galoob asserted that the Game Genie fell under an exception to rights provided to

a copyright owner by the Copyright Act. Specifically, Galoob contended that the Game Genie allowed an "adaptation . . . created as an essential step in the utilization of [a] computer program," which 17 U.S.C. § 117 states is a permissible use of a copyrighted work. The district court granted the injunction, believing at the time it was likely "Nintendo will prevail on its claims that Galoob [has infringed] Nintendo's copyright rights; [and] that Nintendo will suffer immediate and irreparable harm as well as the loss of profits."[1] The district court required Nintendo to post a $100,000 bond as security for the injunction. This amount was later raised to $5 million and then to $15 million. Nintendo resisted these increases, but nevertheless posted bond in the increased amounts.

At the copyright infringement trial, Galoob asserted additional legal theories it had not asserted at the preliminary injunction hearing. It contended that the Game Genie was a fair use of Nintendo's copyrights under 17 U.S.C. § 107 and that the game did not create infringing derivative works. Galoob prevailed at trial and in July 1991 the district court vacated the injunction.[2] The injunction had been in effect approximately one year.

In August 1991, Galoob began selling the Game Genie. It sold about one million units in the United States that year and expected to sell as many as 800,000 in 1992. In September 1991,

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[1] We affirmed the district court's order granting the preliminary injunction in an unpublished memorandum disposition filed January 24, 1991. *See Nintendo of Am., Inc. v. Lewis Galoob Toys, Inc.*, 923 F.2d 862 (9th Cir. 1991)(unpublished disposition).

[2] We affirmed the judgment in May 1992. *Lewis Galoob Toys, Inc. v. Nintendo of Am., Inc.*, 964 F.2d 965 (9th Cir. 1992), *cert. denied*, 113 S. Ct. 1582 (1993).

the district court ordered the execution of the bond in favor of Galoob "in an amount to be determined by the Court."

In December 1991, the court held a "lost sales" hearing to determine the number of Game Genie sales Galoob lost because of the injunction. To establish the number of lost sales, Galoob presented evidence comparing the Game Genie to another NES accessory called the "Nintendo Advantage." The Advantage is a joystick, manufactured and sold by Nintendo. The Advantage permits NES owners to more easily control the characters in video games. The Advantage reached a "market penetration" of ten percent, meaning one Advantage was sold in the United States for every ten NESs. Galoob also presented studies explaining the "Canadian multiplier method," which showed that, in general, a product will sell ten to twelve times as well in the United States as in Canada. Galoob estimated it would sell 190,000 Game Genies in Canada by the end of 1991.

In response to Galoob's assertion of lost sales, Nintendo argued that annual NES sales did not provide a reliable indicator of Game Genie demand. Although annual sales of the NES declined in 1991, the "installed base" or number of NES systems owned in the United States, increased. By the end of 1990, there were 26 million NES systems in the United States, and by the end of 1991, there would probably have been more than 30 million. One of Galoob's marketing documents showed that 93 percent of all NES consoles ever sold were still in use at the end of 1991. On the basis of this evidence, Nintendo contended there was actually an increase in the number of potential Game Genie customers since the district court imposed the injunction.

The district court determined Galoob lost at least 1.6 million Game Genie sales. In arriving at this number, the district court assumed the Game Genie was at least as attractive to NES owners

as was the Nintendo Advantage. Because the NES's installed base was 30 million at the end of 1991, and the Advantage's market penetration was ten percent, Galoob should have sold at least three million Game Genies, or ten percent of 30 million, over the product's lifetime had the court not issued the injunction. To check the accuracy of this estimate, the court applied the Canadian multiplier method, using the estimated total Canadian Game Genie sales of 190,000 and a multiplier of eleven. The resulting 2,090,000 was, in the court's view, "very close to 3 million," and satisfied the court its estimating method was reasonable.

Noting testimony that four million more NES units would be sold in 1992, the district court then added another ten percent, or 400,000 units, to the figure of three million and concluded Galoob would have sold 3.4 million Game Genies over the product's lifetime. The court subtracted the one million Game Genies Galoob actually sold in 1991 and the estimated 800,000 it would sell in 1992. The court concluded Galoob lost 1.6 million Game Genie sales due to the injunction.

This conclusion was based on estimates the court determined were reasonable. The court stated: "I think that these calculations are conservative. I have tried in estimating to take basically the bottom end of everybody's range, and if you want to tell me why that isn't fair, I'm certainly willing to listen."

The district court also held a "profits hearing." At this hearing Galoob established that the average net wholesale price for the Game Genie was $34.28. Nintendo does not contest this figure, but does contest the district court's finding that Galoob's net profit margin was 27.6 percent. The district court applied this percentage to the average net wholesale price to determine Galoob's net profit on each Game Genie (27.6 x $34.28 — $9.46).

To establish its net profit margin percentage, Galoob called an economist. He testified that Galoob's profit margin was 42.74 percent. In arriving at this figure, the economist deducted variable costs allocable to Game Genie sales, but not fixed costs which he described as costs that would have been incurred regardless of Game Genie sales.

Nintendo contested the economist's determination of Galoob's profit margin percentage by challenging his categorization of variable and fixed costs. Nintendo presented an accountant who examined financial data for the Galoob company as a whole and concluded an extra 18.77 percent should be deducted from Galoob's economist's figure of 42.74 percent.

In determining that Galoob's profit margin was 27.6 percent, the court began with the testimony of Galoob's economist that Galoob's profit margin was 42.74 percent. The court stated the economist's method in calculating this figure was a "rational and reliable one." The court agreed with Nintendo's contention, however, that four categories of Galoob's costs, namely, salaries and benefits, travel and entertainment, promotion, and interest, had to be taken into consideration in arriving at the profit margin. It disagreed with Nintendo's contention that as much as 18.77 percent should be deducted from the economist's profit margin figure, but nevertheless lowered the profit margin to 32.74 percent.

Nintendo also disputed the proper allocation of other costs, such as "reworking the Game Genie, tooling, packaging, TV origination, and contract R & D." The court included these factors in its calculations, "[a]ssuming, without deciding, that Nintendo is correct in each of these contentions," and further reduced the profit margin from 32.74 percent to the final figure of 27.6 percent.

By multiplying the 1.6 million unit sales lost by the net wholesale price of $34.28, times the 27.6 percent profit margin, the district court found Galoob suffered at least $15,138,048 in lost profits due to the injunction. The court also calculated Galoob lost $315,569 in interest it would have earned on its loss profits and $480,000 in costs it incurred "when [Galoob] ceased production and distribution and thereafter recommenced those activities upon dissolution of the injunction." Because the total of these amounts exceeded the $15 million bond Nintendo posted, the district court awarded Galoob the entire amount of the bond, plus costs, under Federal Rule of Civil Procedure 65.1. This appeal followed.

STANDARD OF REVIEW

We review de novo a district court's decision to execute a bond. *Matek v. Murat*, 862 F.2d 720, 733 (9th Cir. 1988)(noting the conflict between "abuse of discretion" and "de novo" standards of review among circuits but choosing the latter). An allegation that a district court ignored legal procedure raises a question of law we also review de novo. *Anderson v. United States*, 966 F.2d 487, 489 (9th Cir. 1992). A district court's computation of damages is a finding we review under the clearly erroneous standard. *Stephens v. City of Vista*, 994 F.2d 650, 655 (9th Cir. 1993); *Lum v. Honolulu*, 963 F.2d 1167, 1170 (9th Cir.), *cert. denied*, ___ U.S. ___, 113 S. Ct. 659 (1992); *Galindo v. Stoody Co.*, 793 F.2d 1502, 1516 (9th Cir. 1986).

DISCUSSION

The first issue we consider is whether Galoob was wrongfully enjoined. We conclude it was. We then consider what standard we should apply to ascertain whether the district court erred in determining that Galoob was entitled to damages. Finally, we consider whether the district court erred in computing the amount of damages.

Rule 65(c) of the Federal Rules of Civil Procedure provides:

> No restraining order or preliminary injunction shall issue except upon the giving of security by the applicant, in such sum as the court deems proper, for the payment of such costs and damages as may be incurred or suffered by any party who is found to have been wrongfully enjoined or restrained.

Fed. R. Civ. P. 65(c).

[1] Under this rule, before a court may execute a bond, it must find the enjoined or restrained party was "wrongfully enjoined or restrained."[3] This circuit has yet to define wrongful enjoinment. We hold today that a party has been wrongfully enjoined within the meaning of Rule 65(c) when it turns out the party enjoined had the right all along to do what it was enjoined from doing.[4] *See Blumenthal v. Merrill Lynch Pierce, Fenner &*

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[3] Because this case involves a preliminary injunction rather than a temporary restraining order, we use the term "wrongfully enjoined" rather than "wrongfully restrained."

[4] We prefer the wording of Rule 65(c), which speaks in terms of a party who has been "wrongfully enjoined," rather than the wording in some cases in other circuits which refers to an injunction as having been

Smith, Inc., 910 F.2d 1049, 1954 (2d Cir. 1990)("A party has been 'wrongfully enjoined' under Fed. R. Civ. P. 65(c) if it is ultimately found that the enjoined party had at all times the right to do the enjoined act.").

[2] Here, Nintendo obtained a preliminary injunction enjoining Galoob from selling the Game Genie. As it turned out, Galoob prevailed in the underlying litigation. The district court held Galoob could sell the Game Genie and vacated the preliminary injunction. We affirmed on appeal. *Galoob Toys*, 964 F.2d 965. Thus, Galoob was wrongfully enjoined.

[3] This brings us to the next question: Is Galoob entitled to have the bond executed in its favor? Although there seems to be some variance in how other circuits respond to this question, we join what appears to be the majority and hold there is a rebuttable presumption that a wrongfully enjoined party is entitled to have the bond executed and recover provable damages up to the amount of the bond. *See, e.g., National Kidney Patients Ass'n v. Sullivan*, 958 F.2d 1127, 1134 (D.C. Cir. 1992)(a "defendant injured by a wrongfully issued preliminary injunction is presumptively entitled to recovery on the injunction bond"), *cert. denied*, 113 S. Ct. 966 (1993)

We believe this rule is sound. By adhering to this standard, the party enjoined will usually recover damages, thus discouraging parties from requesting injunctions based on tenuous legal grounds. *See Coyne-Delaney Co. v. Capital Dev. Bd.*, 717 F.2d

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"wrongfully issued." Fed. R. Civ. P. 65(c). A court that complies with the applicable law in issuing a preliminary injunction does not "wrongfully" issue it. Indeed, in an earlier appeal in this case we upheld the district court's issuance of the preliminary injunction. *See Nintendo*, 923 F.2d 862 (unpublished disposition).

385, 392 (7th Cir. 1983)("... [this test] discourages the seeking of preliminary injunctions on flimsy (though not necessarily frivolous) grounds."). Furthermore, a presumption that damages will be awarded from the bond assures district court judges that defendants will receive compensation for their damages in cases where it is later determined a party was wrongfully enjoined. *See* Note, *Recovery for Wrongful Interlocutory Injunctions Under Rule 65(c)*, 99 Harv. L. Rev. 828, 838 n.36 (1986). Moreover, demands on judicial resources may be relieved to some extent, because a defendant who can recover damages against a preliminary injunction bond will be less likely to file a separate malicious prosecution action. *See generally* Note *Interlocutory Injunctions and the Injunction Bond*, 73 Harv. L. Rev. 333 (1959). Finally, this standard provides an equitable means by which courts can decline to impose damages on the rare party who has lost a case on the merits but nevertheless should not suffer the execution of the preliminary injunction bond.

Nintendo argues it rebutted this presumption. Nintendo points out it acted in good faith in bringing its copyright infringement lawsuit, Galoob failed to assert defenses to the preliminary injunction it could have asserted at the preliminary injunction hearing, public policy favors the issuance of injunctions in intellectual property infringement suits, and to award Galoob $15 million imposes a punitive sanction against Nintendo. We consider each of these arguments in turn.

We reject Nintendo's good faith argument. Good faith in the maintenance of litigation is the standard expected of all litigants. That a party lives up to this standard simply means the party did what it ought to have done. On the other hand, if a party obtains a preliminary injunction in bad faith, that party "flunks [the good faith test and] the presumption in favor of enforcement [of the

[bond] congeals virtually into a rock." *National Kidney*, 958 F.2d at 1135.

Nintendo's argument that Galoob failed to assert all of its defenses at the time Nintendo sought the preliminary injunction raises the scepter of bad faith on the part of Galoob. The essence of this argument is that Galoob took advantage of Nintendo by initially making its case appear to be worse than it really was, thus lulling Nintendo into obtaining the preliminary injunction. The implication of the argument is that Galoob cunningly got the court to raise the amount of the bond on two successive occasions, finally pushing it up to $15 million, while concealing the hole cards it intended to play at the time of trial. Nintendo argues it would be inequitable to permit Galoob to recover damages when it pursued such wily litigation tactics. In support of this argument, Nintendo relies on *Page Communications Eng'rs, Inc. v. Froehlke*, 475 F.2d 994 (D.C. Cir. 1973).

Page Communications is inapposite. There, the court declined to award damages to an enjoined defendant in a contract action. The defendant earlier agreed to produce "all 'records relating to the evaluation of proposals submitted' by the various offerors, and all 'documents setting forth the basis for award.'" *Page Communications*, 475 F.2d at 996. Although this language described a particular report the defendant possessed, the defendant intentionally declined to produce the report. In granting the injunction for the plaintiff, the district court believed erroneously it had examined all the relevant evidence. Because the defendant was responsible for the missing evidence, and because the district court would probably not have granted the injunction had it seen the report, the court concluded that in light of these circumstances, it would be inequitable to assess damages against the plaintiff. *Id.* at 997.

[4] Here, Galoob did not fail to produce evidence. It did not deceive the court. There is no indication in the record that Galoob sandbagged Nintendo into prevailing on its application for the preliminary injunction, knowing all the while that it could have defeated that application. Those facts simply are not in this case. All that appears is that Galoob had additional defenses it asserted at the time of trial, defenses it had not asserted at the preliminary injunction hearing. And while it is true Galoob persuaded the court on two successive occasions to increase the amount of the bond, thus raising the stakes of the game, it is also true that Nintendo called these raises by putting up additional amounts of the bond. We conclude Galoob's litigation conduct does not preclude it from recovering on the bond.

Nintendo's public policy argument is premised on its assertion that public policy favors the issuance of injunctions in intellectual property infringement lawsuits. This assertion is correct only when a *permanent* injunction is sought once infringement has been established. *See, e.g., Universal City Studios, Inc. v. Sony Corp. of Am.*, 659 F.2d 963, 976 (9th Cir. 1981) ("We note that, as a general rule, a copyright plaintiff is entitled to a *permanent* injunction *when liability has been established* and there is a threat of continuing violations.") (emphasis added), *rev'd on other grounds*, 464 U.S. 417 (1984). Public policy does not advocate the liberal issuance of *preliminary* injunctions in copyright infringement actions.

We reject Nintendo's argument that the district court awarded punitive damages by executing the bond in favor of Galoob. The damage award was not punitive, but compensatory. Every dollar the court awarded to Galoob compensated it for the injury it had suffered because of the injunction. *Cf. Coyne-Delaney*, 717 F.2d at 392.

We next consider whether the district court erred in determining that Galoob suffered at least $15 million in damages by reason of the issuance of the injunction. Nintendo argues the court failed to require Galoob to meet any burden of proof in establishing its damages. The record belies this contention. In its order directing entry of partial judgment, the district court stated, "Galoob has proved by a preponderance of the evidence that it sustained actual injury as a result of the wrongful issuance of the preliminary injunction." The court explicitly named the standard it applied to Galoob and explicitly stated Galoob met that burden.

Nintendo challenges this finding. It argues Galoob failed to prove with reasonable certainty that it suffered any damage. *See Palmer v. Connecticut Ry. & Lighting Co.*, 311 U.S. 544, 561 (1941) ("Certainty in the fact of damage is essential."). According to Nintendo, Galoob was not damaged by the injunction because the injunction only delayed Game Genie sales, it did not prevent them permanently. That is, although NES owners who wanted to purchase the Game Genie in 1990 could not do so because of the injunction, they most likely waited a year until the injunction was lifted, and then bought the product anyway.

[5] We reject this argument. It is premised largely on speculation, and as the district court stated, it "defies common sense." Galoob established with reasonable certainty that it was damaged by the issuance of the injunction.

The next question is: Did the district court err in computing the amount of damages Galoob suffered? "The district court's computation of damages . . . is . . . insulated from review unless clearly erroneous." *Laborers Clean-Up Contract Admin. Trust Fund v. Uriarte Clean-Up Serv., Inc.*, 736 F.2d 516, 520 n.2 (1984); *see also Lum*, 963 F.2d at 1170 (upholding damage award where the award was "not extreme or outrageous").

Throughout its calculation of damages, the district court chose figures favoring Nintendo. The court assumed the Game Genie would sell only as well as the Nintendo Advantage, even though the Advantage was, in its opinion, "not as versatile or long-lasting a peripheral" as the Game Genie. When the court checked the accuracy of its estimate of lost sales, using the Canadian multiplier method, it chose a figure of 190,000 Canadian sales, which was "at the conservative end of the level," and used a multiplier of eleven, which was far below the multiplier of thirty-eight that the Advantage enjoyed. The court also adopted Galoob's highest estimate of its anticipated 1992 sales. It then deducted this high-end estimate, together with Galoob's actual 1991 sales, from the total sales it determined Galoob would have made "but for" the issuance of the injunction.

[6] In sum, in determining the number of lost sales, the district court repeatedly used the most conservative ends of available ranges. While it is true that Galoob did not likely lose *exactly* 1.6 million sales of the Game Genie, it is reasonably certain it lost at least that amount. The district court's method of calculating the number of lost sales was not erroneous.

With regard to the court's finding that Galoob's profit margin for the Game Genie was 27.6 percent, the court began with the "rational and reliable" estimate of Galoob's economist that the profit margin was 42.74 percent, considered the evidence and contentions of the parties and

reduced that figure to 27.6 percent. It did not clearly err in making this funding.

CONCLUSION

[7] Galoob was wrongfully enjoyed from selling the Game Genie. As a result, it was presumptively entitled to recover damages. Nintendo did not rebut this presumption. Galoob proved with reasonable certainty it was damaged by the injunction. The district court did not err in finding Galoob's damages exceeded the $15 million amount of the bond. Galoob was entitled to have the full amount of the bond executed in its favor.

AFFIRMED.

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

NINTENDO OF AMERICA, INC., *Plaintiff-Appellant,* v. LEWIS GALOOB TOYS, INC., *Defendant-Appellee.*	No. 92-16364 D.C. No. CV-90-01440-FMS ORDER

Before: LAY*, HALL and THOMPSON, Circuit Judges.

The panel, as constituted above, has unanimously voted to deny the petition for rehearing. Judges Hall and Thompson voted to reject the suggestion for rehearing en banc, and Judge Lay so recommended.

The suggestion for en banc rehearing has been circulated to the full court, and no judge of the court has requested a vote on the suggestion for rehearing en banc. Fed. R. App. P. 35(b).

The petition for rehearing is DENIED, and the suggestion for a rehearing en banc is REJECTED.

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* Hon. Donald P. Lay, Senior Circuit Judge for the Eighth Circuit, sitting by designation.

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

LEWIS GALOOB TOYS, INC., *Plaintiff-Appellee,* v. NINTENDO OF AMERICAN, INC., *Defendant-Appellant.*	No. 921-16205 D.C. No. CV-90-1586 FMS AMENDED OPINION
NINTENDO OF AMERICA, INC., *Plaintiff-Appellee,* v. LEWIS GALOOB TOYS, INC., *Defendant-Appellant.*	D.C. No. CV-90-1586 FMS OPINION

Appeal from the United States District Court
for the Northern District of California
Fern M. Smith, District Judge, Presiding

Argued and Submitted
March 12, 1992 - San Francisco, California
Filed May 21, 1992
Amended August 5, 1992

Before: Jerome Farris and Pamela Ann Rymer, Circuit Judges, and David V. Kenyon,* District Judge.

Opinion by Judge Farris

COUNSEL

Thomas G. Gallatin, Jr., Mudge, Rose, Guthrie, Alexander & Ferdon, New York, New York, for the defendant-appellant.

Jerome B. Falk, Jr., Howard, Rice, Nemerovski, Canady, Robertson & Falk, San Francisco, California, for the plaintiff-appellees.

OPINION

FARRIS, Circuit Judge:

Nintendo of America appeals the district court's judgment following a bench trial (1) declaring that Lewis Galoob Toys' Game Genie does not violate any Nintendo copyrights and dissolving a temporary injunction and (2) denying Nintendo's request for a permanent injunction enjoining Galoob from marketing the Game Genie. *Lewis Galoob Toys, Inc. v. Nintendo of America, Inc.*, 780 F. Supp. 1283 (N.D. Cal. 1991). We have appellate jurisdiction pursuant to 15 U.S.C. § 1121 and 28 U.S.C. §§1291 and 1292(a)(1). We affirm.

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* Honorable David V. Kenyon, United States District Judge for the Central District of California, sitting by designation.

FACTS

The Nintendo Entertainment System is a home video game system marketed by Nintendo. To use the system, the player inserts a cartridge containing a video game that Nintendo produces or licenses others to produce. By pressing buttons and manipulating a control pad, the player controls one of the game's characters and progresses through the game. The games are protected as audiovisual works under 17 U.S.C. § 102(a)(6).

The Game Genie is a device manufactured by Galoob that allows the player to alter up to three features of a Nintendo game. For example, the Game Genie can increase the number of lives of the player's character, increase the speed at which the character moves, and allow the character to float above obstacles. The player controls the changes made by the Game Genie by entering codes provided by the Game Genie Programming Manual and Code Book. The player also can experiment with variations of these codes.

The Game Genie functions by blocking the value for a single data byte sent by the game cartridge to the central processing unit in the Nintendo Entertainment System and replacing it with a new value. If that value controls the character's strength, for example, then the character can be made invincible by increasing the value sufficiently. The Game Genie is inserted between a game cartridge and the Nintendo Entertainment System. The Game Genie does not alter the data that is stored in the game cartridge. Its effects are temporary.

DISCUSSION

1. *Derivative work*

The Copyright Act of 1976 confers upon copyright holders the exclusive right to prepare and authorize others to prepare derivative works based on their copyrighted works. See 17 U.S.C. § 106(2). Nintendo argues that the district court erred in concluding that the audiovisual displays created by the Game Genie are not derivative works. The court's conclusions of law are reviewed *de novo*. *See Rozay's Transfer v. Local Freight Drivers, Local 208*, 850 F.2d 1321, 1326 (9th Cir. 1988), *cert. denied*, 490 U.S. 1030 (1989). Its findings of fact are reviewed for clear error. *See id.*

A derivative work must incorporate a protected work in some concrete or permanent "form." The Copyright Act defines a derivative work as follows:

> A "derivative work" is a work based upon one or more preexisting works, such as a translation, musical arrangement, dramatization, fictionalization, motion picture version, sound recording, art reproduction, abridgment, condensation, or any other form in which a work may be recast, transformed, or adapted. A work consisting of editorial revisions, annotations, elaborations, or other modifications which, as a whole, represent an original work of authorship, is a "derivative work."

17 U.S.C. § 101 (emphasis added). The examples of derivative works provided by the Act all physically incorporate the underlying work or works. The Act's legislative history similarly

indicates that "the infringing work must incorporate a portion of the copyrighted work in some form." 1976 U.S. Code Cong. & Admin. News 5659, 5675. *See also Mirage Editions, Inc. v. Albuquerque A.R.T. Co.*, 856 F.2d 1341, 1343-44 (9th Cir. 1988) (discussing same), *cert. denied*, 489 U.S. 1018 (1989).

Our analysis is not controlled by the Copyright Act's definition of "fixed." The Act defines copies as "material objects, other than phonorecords, in which a work is *fixed* by any method." 17 U.S.C. § 101 (emphasis added). The Act's definition of "derivative work," in contrast, lacks any such reference to fixation. *See id.* Further, we have held in a copyright infringement action that "[i]t makes no difference that the derivation may not satisfy certain requirements for statutory copyright registration itself." *Lone Ranger Television v. Program Radio Corp.*, 740 F.2d 718, 722 (9th Cir. 1984). *See also* Paul Goldstein, *Derivative Rights and Derivative Works in Copyright*, 30 J. Copyright Soc'y U.S.A. 209, 231 n.75 (1983) ("the Act does not require that the derivative work be protectable for its preparation to infringe"). *Cf. Kalem Co. v. Harper Bros.*, 222 U.S. 55, 61(1911) (finding the movie "Ben Hur" infringed copyright in the book *Ben Hur* even though Copyright Act did not yet include movies as protectable works). A derivative work must be fixed to be protected under the Act, *see* 17 U.S.C. § 102(a), but not to *infringe*.

The argument that a derivative work must be fixed because "[a] 'derivative work' is a work," 17 U.S.C. § 101, and "[a] work is 'created' when it is fixed in a copy or phonorecord for the first time," *id.*, relies on a misapplication of the Copyright Act's definition of "created":

> A work is 'created' when it is fixed in a copy or phonorecord for the first time; where a work is prepared over a period of time, the portion of it that has been

> fixed at any particular time constitutes the work as of that time, and where the work has been prepared in different versions, each version constitutes a separate work.

Id. The definition clarifies the time at which a work is *created*. If the provision were a definition of "work," it would not use that term in such a casual manner. The Act does not contain a definition of "work." Rather, it contains specific definitions: "audiovisual works," "literary works," and "pictorial, graphic and sculptural works," for example. The definition of "derivative work" does not require fixation.

The district court's finding that no independent work is created, *see Galoob*, 780 F. Supp. at 1291, is supported by the record. The Game Genie merely enhances the audiovisual displays (or underlying data bytes) that originate in Nintendo game cartridges. The altered displays do not incorporate a portion of a copyrighted work in some concrete or permanent *form*. Nintendo argues that the Game Genie's displays are as fixed in the hardware and software used to create them as Nintendo's original displays. Nintendo's argument ignores the fact that the Game Genie cannot produce an audiovisual display; the underlying display must be produced by a Nintendo Entertainment System and game cartridge. Even if we were to rely on the Copyright Act's definition of "fixed," we would similarly conclude that the resulting display is not "embodied," *see* 17 U.S.C § 101, in the Game Genie. It cannot be a derivative work.

Mirage Editions is illustrative. Albuquerque A.R.T. transferred artworks from a commemorative book to individual ceramic tiles. *See Mirage Editions*, 856 F.2d at 1342. We held that "[b]y borrowing and mounting the preexisting, copyrighted individual art images without the consent of the copyright

proprietors... [Albuquerque A.R.T.] has prepared a derivative work and infringed the subject copyrights." *Id.* at 1343. The ceramic tiles *physically* incorporated the copyrighted works in a form that could be sold. Perhaps more importantly, sales of the tiles supplanted purchasers' demand for the underlying works. Our holding in *Mirage Editions* would have been much different if Albuquerque A.R.T. had distributed lenses that merely enabled users to view several artworks simultaneously.

Nintendo asserted at oral argument that the existence of a $150 million market for the Game Genie indicates that its audiovisual display must be fixed. We understand Nintendo's argument; consumers clearly would not purchase the Game Genie if its display was not "sufficiently permanent or stable to permit it to be perceived. . . for a period of more than transitory duration." 17 U.S.C. § 101. But, Nintendo's reliance on the Copyright Act's definition of "fixed" is misplaced. Nintendo's argument also proves too much; the existence of a market does not, and cannot, determine conclusively whether a work is an infringing derivative work. For example, although there is a market for kaleidoscopes, it does not necessarily follow that kaleidoscopes create unlawful derivative works when pointed at protected artwork. The same can be said of countless other products that enhance, but do not replace, copyrighted works.

Nintendo also argues that our analysis should focus exclusively on the audiovisual displays created by the Game Genie, *i.e.*, that we should compare the altered displays to Nintendo's original displays. Nintendo emphasizes that "'[a]udiovisual works' are works that consist of a series of related images . . . *regardless of the nature of the material objects . . . in which the works are embodied.*" 17 U.S.C. § 101 (emphasis added). The Copyright Act's definition of "audiovisual works" is inapposite; the *only* question before us is whether the audiovisual

displays created by the Game Genie are "derivative works." The Act does not similarly provide that a work can be a derivative work regardless of the nature of the material objects in which the work is embodied. A derivative work must incorporate a protected work in some concrete or permanent form. We cannot ignore the actual source of the Game Genie's display.

Nintendo relies heavily on *Midway Mfg. Co. v. Artic Int'l, Inc.*, 704 F.2d 1009 (7th Cir.), *cert. denied*, 464 U.S. 823 (1983). *Midway* can be distinguished. The defendant in Midway, Artic International, marketed a computer chip that could be inserted in Galaxian video games to speed up the rate of play. The Seventh Circuit held that the speeded-up version of Galaxian was a derivative work. *Id.* at 1013-14. Artic's chip substantially copied and *replaced* the chip that was originally distributed by Midway. Purchasers of Artic's chip also benefited economically by offering the altered game for use by the general public. The Game Genie does not physically incorporate a portion of a copyrighted work, nor does it supplant demand for a component of that work. The court in *Midway* acknowledged that the Copyright Act's definition of "derivative work" "must be stretched to accommodate speeded-up video games." *Id.* at 1014. Stretching that definition further would chill innovation and fail to protect "society's competing interest in the free flow of ideas, information, and commerce." *Sony Corp. of America v. Universal Studios, Inc.*, 464 U.S. 417, 429 (1984).

In holding that the audiovisual displays created by the Game Genie are not derivative works, we recognize that technology often advances by improvement rather than replacement. *See* Christian H. Nadan, Note, *A Proposal to Recognize Component Works: How a Teddy Bears on the Competing Ends of Copyright Law*, 78 Cal. L. Rev. 1633, 1635 (1990). Some time ago, for example, computer companies began marketing spell-checkers that operate

within existing word processors by signalling the writer when a word is misspelled. These applications, as well as countless others, could not be produced and marketed if courts were to conclude that the word processor and spell-checker combination is a derivative work based on the word processor alone. The Game Genie is useless by itself. It can only enhance, and cannot duplicate or recast, a Nintendo game's output. It does not contain or produce a Nintendo game's output in some concrete or permanent form, nor does it supplant demand for Nintendo game cartridges. Such innovations rarely will constitute infringing derivative works under the Copyright Act. *See generally* Nadan, *supra*, at 1667-72.

2. *Fair use*

"The doctrine of fair use allows a holder of the privilege to use copyrighted material in a reasonable manner without the consent of the copyright owner." *Narell v. Freeman*, 872 F.2d 907, 913 (9th Cir. 1989) (citations omitted). The district court concluded that, even if the audiovisual displays created by the Game Genie are derivative works, Galoob is not liable under 17 U.S.C. § 107 because the displays are a fair use of Nintendo's copyrighted displays. "whether a use of copyrighted material is a 'fair use' is a mixed question of law and fact. If the district court found sufficient facts to evaluate each of the statutory factors, the appellate court may decide whether defendants may claim the fair use defense as a matter of law." *Abend v. MCA, Inc.*, 863 F.2d 1465, 1468 (9th Cir. 1988), *aff'd sub nom. Stewart v. Abend*, 495 U.S. 207 (1990).

Section 107 codifies the fair use defense:

> In determining whether the use made of a work in any particular case is a fair use the factors to be considered shall include -
>
> (1) the purpose and character of the use, including whether such use is of a commercial nature or is for nonprofit educational purposes;
>
> (2) the nature of the copyrighted work;
>
> (3) the amount and substantiality of the portion used in relation to the copyrighted work as a whole;
>
> (4) the effect of the use upon the potential market for or value of the copyrighted work.

The factors are nonexclusive, *see Fisher v. Dees*, 794 F.2d 432, 435 (9th Cir. 1986), and section 107 does not indicate how much weight should be ascribed to each.

Much of the parties' dispute regarding the fair use defense concerns the proper focus of the court's inquiry: (1) Galoob or (2) consumers who purchase and use the Game Genie. Nintendo's complaint does not allege direct infringement, nor did it try the case on that theory. The complaint, for example, alleges only that "Galoob's marketing advertising [sic], promoting and selling of Game Genie has and will contribute to the creation of infringing derivatives of Nintendo's copyrighted . . . games." (emphasis added). Contributory infringement is a form of third party liability. *See* Melville B. Nimmer & David Nimmer, *3 Nimmer on Copyright* § 12.04[A][2], at 12-68 (1991). The district court properly focused on whether consumers who purchase and use the Game Genie would be infringing Nintendo's copyrights by creating (what are now assumed to be) derivative works.

Nintendo emphasizes that the district court ultimately addressed its direct infringement by authorization argument. The

court concluded that, "(b]ecause the Game Genie does not create a derivative work when used in conjunction with a copyrighted video game, Galoob does not 'authorize the use of a copyrighted work without the actual authority from the copyright owner.'" *Galoob*, 780 F. Supp. at 1298 (quoting *Sony*, 464 U.S. at 435 n.17). Although infringement by authorization is a form of direct infringement, this does not change the proper focus of our inquiry; a party cannot authorize another party to infringe a copyright unless the authorized conduct would itself be unlawful.

Nintendo disputes this conclusion. According to Nintendo, a party can unlawfully authorize another party to use a copyrighted work even if that party's use of the work would not violate the Copyright Act. Nintendo's argument is unpersuasive. In *Sony*, 464 U.S. at 449, for example, the Court considered whether *consumers* were using the Betamax for a commercial or noncommercial purpose even though Sony itself obviously was acting in its own commercial self-interest. Professor Nimmer similarly concludes that, "to the extent that an activity does not violate one of those five enumerated rights [see 17 U.S.C. § 106], authorizing such activity does not constitute copyright infringement." 3 *Nimmer on Copyright* § 12.04[A][3][a], at 12-80 n.82.

The district court concluded that "a family's use of a Game Genie for private home enjoyment must be characterized as a non-commercial, nonprofit activity." *Galoob*, 780 F. Supp. at 1293. Nintendo argues that Game Genie users are supplanting its commercially valuable right to make and sell derivative works. Nintendo's reliance on *Harper & Row Publishers, Inc. v. Nation Enters.*, 471 U.S. 539, 562 (1985), is misplaced. The commercially valuable right at issue in *Harper & Row* was the right of first publication; Nation Enterprises intended to publish the copyrighted materials *for profit*. *See id.* at 562-63. *See also Sony*, 464 U.S. at 449 ("If the Betamax were used to make copies

for a commercial or profit-making purpose, such use would presumptively be unfair."). Game Genie users are engaged in a non-profit activity. Their use of the Game Genie to create derivative works therefore is presumptively fair. *See Sony*, 464 U.S. at 449.

The district court also concluded that "[t]he [Nintendo] works' published nature supports the fairness of the use." *Galoob*, 780 F. Supp. at 1293. Nintendo argues that it has not published the derivative works created by the Game Genie. This argument ignores the plain language of section 107: "the factors to be considered shall include . . . the nature of the *copyrighted* work." The argument also would make the fair use defense unavailable in all cases of derivative works, including "criticism, comment, news reporting, teaching . . . , scholarship, or research." 17 U.S.C. § 107. A commentary that incorporated large portions of *For Whom the Bell Tolls* for example, would be undeserving of fair use protection because the incorporated portions would constitute an unpublished derivative work. This cannot be the law.

The district court further concluded that the amount of the portion used in relation to the copyrighted work as a whole "cannot assist Nintendo in overcoming the presumption of fair use." *Galoob*, 780 E Supp. at 1293. The video tape recorders at issue in *Sony* allowed consumers to tape copyrighted works in their entirety. The Supreme Court nevertheless held that, "when one considers . . . that [video tape recording] merely enables a viewer to see such a work which he had been invited to witness in its entirety free of charge, the fact that the entire work is reproduced does not have its ordinary effect of militating against a finding of fair use." 464 U.S. at 449-50 (citations omitted). Consumers are not invited to witness Nintendo's audiovisual displays free of charge, but, once they have paid to do so, the fact that the derivative works created by the Game Genie are

comprised almost entirely of Nintendo's copyrighted displays does not militate against a finding of fair use.

Nintendo would distinguish *Sony* because it involved copying copyrighted works rather than creating derivative works based on those works. In other words, the consumers in *Sony* could lawfully copy the copyrighted works because they were invited to view those works free of charge. Game Genie users, in contrast, are not invited to view derivative works based on Nintendo's copyrighted works without first paying for that privilege. *Sony* cannot be read so narrowly. It is difficult to imagine that the Court would have reached a different conclusion if Betamax purchasers were skipping portions of copyrighted works or viewing denouements before climaxes. *Sony* recognizes that a party who distributes a copyrighted work cannot dictate how that work is to be enjoyed. Consumers may use a Betamax to view copyrighted works at a more convenient time. They similarly may use a Game Genie to enhance a Nintendo Game cartridge's audiovisual display in such a way as to make the experience more enjoyable.

"The fourth factor is the 'most important, and indeed, central fair use factor.'" *Stewart*, 495 U.S. at 238 (quoting 3 *Nimmer on Copyright* § 13.05[A], at 13-81). The district court concluded that "Nintendo has failed to show any harm to the present market for its copyrighted games and has failed to establish the reasonable likelihood of a potential market for slightly altered versions of the games at suit." *Galoob*, 780 F. Supp. at 1295. Nintendo's main argument on appeal is that the test for market harm encompasses the potential market for derivative works. Because the Game Genie is used for a noncommercial purpose, the likelihood of future harm may not be presumed. *See Sony*, 464 U.S. at 451. Nintendo must show "by a preponderance of the evidence that *some* meaningful likelihood of future harm exists." Id. (emphasis supplied).

Nintendo's argument is supported by case law. Although the Copyright Act requires a court to consider "the effect of the use upon the potential market for or value of the *copyrighted work*," 17 U.S.C. § 107(4) (emphasis added), we held in *Abend* that "[a]lthough the motion picture will have no adverse effect on bookstore sales of the [underlying] novel - and may in fact have a beneficial effect - it is 'clear that [the film's producer] may not invoke the defense of fair use.'" 863 F.2d at 1482 (quoting 3 *Nimmer on Copyright* § 13.05[B], at 13-84). We explained: "'If the defendant's work adversely affects the value of any of the rights in the copyrighted work... the use is not fair even if the rights thus affected have not as yet been exercised by the plaintiff.'" *Id.* (quoting 3 *Nimmer on Copyright* § 13.05[B], at 13-84 to 13-85 (footnotes omitted)). The Supreme Court specifically affirmed our finding that the motion picture adaptation "impinged on the ability to market new versions of the story." *Stewart*, 495 U.S. at 238.

Still, Nintendo's argument is undermined by the facts. The district court considered the potential market for derivative works based on Nintendo game cartridges and found that: (1) "Nintendo has not, to date, issued or considered issuing altered versions of existing games," *Galoob*, 780 F. Supp. at 1295, and (2) Nintendo "has failed to show the reasonable likelihood of such a market." *Id.* The record supports the court's findings. According to Stephen Beck, Galoob's expert witness, junior or expert versions of existing Nintendo games would enjoy very little market interest because the original version of each game already has been designed to appeal to the largest number of consumers. Mr. Beck also testified that a new game must include new material or "the game player is going to feel very cheated and robbed, and [the] product will have a bad reputation and word of mouth will probably kill its sales." Howard Lincoln, Senior Vice President of

Nintendo of America, acknowledged that Nintendo has no present plans to market such games.

The district court also noted that Nintendo's assertion that it may wish to re-release altered versions of its game cartridges is contradicted by its position in various other lawsuits:

> In those actions, Nintendo opposes antitrust claims by using the vagaries of the video game industry to rebut the impact and permanence of its market control, if any. Having indoctrinated this Court as to the fast pace and instability of the video game industry, Nintendo may not now, without any data, redefine that market in its request for the extraordinary remedy sought herein. . . . While board games may never die, good video games are mortal.

Galoob, 780 F. Supp. at 1295. The existence of this potential market cannot be presumed. *See Sony*, 464 U.S. at 451. *See also Wright v. Warner Books, Inc.*, 953 F.2d 731, 739 (2d Cir. 1991) (affirming district court's finding of no reasonable likelihood of injury to alleged market because "[p]laintiff has offered no evidence that the project will go forward"). The fourth and most important fair use factor also favors Galoob.

Nintendo's most persuasive argument is that the creative nature of its audiovisual displays weighs against a finding of fair use. The Supreme Court has acknowledged that "fair use is more likely to be found in factual works than fictional works. *Stewart*, 495 U.S. at 237. This consideration weighs against a finding of fair use, but it is not dispositive. *See Sony*, 464 U.S. at 448 (fair use defense is an "equitable rule of reason"). The district court could properly conclude that Game Genie users are making a fair use of Nintendo's displays.

3. *Temporary and permanent injunction*

Galoob has not violated the Copyright Act. Nintendo therefore is not entitled to a temporary or permanent injunction.

AFFIRMED.

RYMER, Circuit Judge, concurring in the judgment:

I concur in the judgment for reasons stated by the district court, *Lewis Galoob Toys, Inc. v. Nintendo of America, Inc.*, 780 F. Supp. 1283 (N.D.Cal.1991).

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

LEWIS GALOOB TOYS, INC., *Plaintiff (s),* vs. NINTENDO OF AMERICA, INC., *Defendant (s).*	No. C-90-1440 FMS No. C-90-1586 FMS MEMORANDUM OF DECISION
AND RELATED AND CONSOLIDATED ACTIONS	(Filed JULY 12 1991)

INTRODUCTION

These two consolidated suits test the scope of copyright protection for audio-visual games (video games). Nintendo of America, Inc. ("Nintendo") markets and sells home video games hardware systems and compatible video game cartridges. The audio-visual portions of the game cartridges in suit are protected by registered copyrights held by Nintendo.

Lewis Galoob Toys, Inc. ("Galoob") markets and sells toy products. Galoob has a license to market a video game accessory known as the Game Genie Video Game Enhancer ("Game Genie"), which attaches to a video game cartridge and allows the player to temporarily alter certain attributes of the video game. It is sold for personal consumer use only, not for video game arcades. The Game Genie does not create a separate copy of the

original video game, does not make permanent changes to the original game work, and can only be used when attached to the original game.

Nintendo contends that the Game Genie creates a derivative work as defined in 17 U.S.C. § 101, and that Galoob is therefore either a direct or contributory infringer of Nintendo's copyrights in the original video games in suit.

For the reasons set forth below, the Court finds to the contrary and vacates the pending preliminary injunction forthwith.

SUMMARY OF RULINGS

This case has included one and one-half years of litigation, a two-week trial, and extensive briefing of all issues, both pre- and post-trial. After careful consideration of the evidence and briefing submitted by both sides, and for the reasons set forth below, this Court rules as follows:

1) Use of the Game Genie by consumers to temporarily alter copyrighted video games for their own enjoyment does not create a derivative work under 17 U.S.C. § 101. Because the consumers are not direct infringers, Galoob is not a contributory infringer.

2) In the alternative, even if the Game Genie did create a derivative product, the doctrine of "fair use" enables consumers to use the Game Genie for their personal enjoyment, 17 U.S.C. § 107, and therefore allows Galoob to sell it.

3) Galoob's use of copyrighted video games for purposes of testing or marketing the Game Genie does not violate any of Nintendo's rights under the Copyright Act.

4) On this record, injunctive relief is not appropriate for either side.

PROCEDURAL BACKGROUND

On May 17, 1990, Galoob filed a complaint for declaratory relief against Nintendo, seeking a declaratory judgment that the Game Genie does not violate or contribute to the violation of any of Nintendo's video game copyrights. Galoob also sought an injunction prohibiting Nintendo from interfering with the marketing of the Game Genie, and permanently enjoining Nintendo from modifying the Nintendo Entertainment System ("NES") in order to make it incompatible with the Game Genie.

Nintendo responded by filing its own complaint for an injunction prohibiting Galoob from all facets of marketing the Game Genie, on the grounds that it contributorily infringed Nintendo's registered copyrights in various video games. Nintendo also claimed violation of the trademark laws.

On July 2, 1990, this Court (per Schnacke, J.) issued a preliminary injunction in favor of Nintendo; the injunction was affirmed by the United States Court of Appeals for the Ninth Circuit on February 27, 1991.

Both actions were transferred on July 6, 1990 to the undersigned, who consolidated them and held a bench trial on the sole issue of whether or not the Game Genie infringes any of Nintendo's copyrights. Nintendo claims that Galoob has wilfully and deliberately infringed, both directly and contributorily, Nintendo's copyrights in its audio-visual game cartridges. Galoob seeks a declaration that use of the Game Genie by individuals in their own homes does not constitute infringement of Nintendo's copyrights, and that Galoob's marketing, distribution, and sale of

the Game Genie is therefore not contributory infringement of those copyrights. In addition, Galoob seeks a declaration that its own use of the Game Genie for testing and marketing purposes does not constitute direct infringement.

PARTIES

Galoob is a corporation organized and existing under the laws of Delaware, with its principal place of business in South San Francisco, California. Nintendo is a Washington state corporation, with its principal place of business at Redmond, Washington, and is a wholly owned subsidiary of Nintendo Company, Ltd., of Japan. Galoob and Nintendo are the only two parties to these consolidated actions. No individual consumers of the Game Genie have been named as defendants, although it is their use of the Game Genie that allegedly constitutes the primary infringing activity.

JURISDICTION AND VENUE

This civil action arises under the Copyright Act, as amended 17 U.S.C. § 101 et seq.; the Lanham Act, 15 U.S.C. § 1051 et seq.; and California law. This Court has subject matter jurisdiction pursuant to 17 U.S.C. § 501; 15 U.S.C. § 1121; and 28 U.S.C. § 1331, 1332, and 1338.

Venue is proper in this district pursuant to 28 U.S.C. § 1391 and 1400(a).

FINDINGS OF FACT AND CONCLUSIONS OF LAW

I. PRODUCTS

This suit involves the interplay of three products, the Nintendo Entertainment System, Nintendo copyrighted video games and the Game Genie.

A. The Nintendo Entertainment System

Nintendo markets and sells video game hardware systems. The system is known as the Nintendo Entertainment System ("NES") and is designed for playing video games in the home. Nintendo has sold in excess of 25,000,000 of these systems in the United States. Nintendo also markets and sells video game cartridges, and licenses third parties to market and sell video games which are compatible with Nintendo's hardware. The video games are displayed on a home television.

The NES includes a microprocessor-based console, the "control deck," which houses two processing units: the central processing unit ("CPU"), which controls the overall operation of the system, and the picture processing unit ("PPU"), which generates the pictures for display on the television. The control deck is connected to the television.

B. Video Games

The video games which may be played on the NES control deck are both audio-visual works and computer programs. The audio-visual works and game programs are permanently stored on ROMs (*i.e.*, Read Only Memory chips) contained in game cartridges.

Nintendo owns valid and subsisting registered copyrights in the audio-visual programs contained in many of its video games, including those in suit.

Each game typically has a theme and a goal. For example, a game might consist of the main character's attempt to obtain a certain level of points before he is defeated by hostile forces.[1] In an attempt to reach that point goal, he has a certain number of chances ("lives") in which to [sic] must overcome obstacles, battle adversaries, and travel through various levels ("worlds"). Each time he overcomes an obstacle or reaches a new world, additional points are added to the score. On the other hand, each time he is defeated by a villain and/or obstacle, he loses a chance or life. If he loses all of his lives before obtaining a certain number of points, the game ends, and he must start again.

More than 500 different video games have been produced and offered for sale for use with the NES Control Deck. In addition to those owned and copyrighted directly by Nintendo, hundreds of games have been produced by some 71 other companies. Sixty-three of the non-Nintendo producers of video games have licenses from Nintendo, and an additional eight do not.

Players can buy various devices ("interactive devices") which connect to the NES control deck and allow the player to influence various aspects of the game being played. Changes include speeding up certain aspects of the game, skipping one or more levels of play, etc. Interactive devices which may be used with the NES control deck include devices marketed as the "Control Pad," "NES Advantage," "Power Glove," "NES Max," and "Turbo Blaster." Light guns may also be used by players for playing

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[1] For reasons that remain obscure, the protagonists are generally male.

certain games. Nintendo markets and sells, or licenses others to sell, such interactive devices for use with the NES control deck.

The NES video game cartridges contain two separate memories: one memory (the "program memory") is connected to the CPU when the game cartridge is physically inserted into the control deck; the other memory (the "character memory") is connected to the PPU when the game cartridge is physically inserted into the control deck.

In order to play an NES video game, the player inserts a game cartridge into the control deck. The player begins game play and interacts with the video game by manipulating buttons on the standard controller, which is sold with the NES and which attaches to the control deck.

The game's action is performed on the television screen. Players use the controller (which contains a four-way control pad, for directional control, and four other buttons labeled "start," "select," "A" and "B") to guide the actions of "their" character in an attempt to reach the game's goal, as described earlier.

The copyrights allegedly infringed in this suit are for the audio-visual portion of the video game cartridges manufactured by Nintendo. The games are only compatible for play on the NES; they have a retail list price of approximately $40 to $50 each.

C. The Game Genie

Galoob is in the business of marketing and selling toy products in the United States. Galoob obtained a license to market the Game Genie from Codemasters Software Co., Ltd., a United Kingdom corporation, and Camerica, Ltd., a Canadian corporation. The Game Genie, the accused product, allows players

to alter certain attributes of video games, in ways similar to the interactive devices and published codes described *supra* at 7-8 and *infra* at 35.

The Game Genie can function in combination with any NES-compatible game cartridge. Six licensed producers of copyrighted Nintendo-compatible games, as well as Nintendo itself, are known to object to the use of the Game Genie with their copyrighted games. It is not known whether the nontestifying Nintendo-licensees or the eight nonlicensed producers of NES-compatible games object or consent to the use of the Game Genie with their copyrighted games, nor is it known how many of the games of Nintendo licensees or nonlicensee producers have registered copyrights.

At this time, the Game Genie is configured both electronically and physically to plug into NES control decks and NES-compatible video game cartridges only; it has no other use.

The Game Genie is designed to fit between the NES control deck and NES-compatible video game cartridges. When a Game Genie is used (*i.e.*, when a game cartridge has been attached to a Game Genie and the Game Genie is then inserted into a control deck), it has two modes of operation: a programming or "set-up" mode, and a game play mode.

If the game cartridge is detached from the Game Genie during operation, all audio-visual displays of the game cease. Likewise, if a game cartridge inserted into a control deck without the Game Genie is removed from the control deck, all game audio-visual displays cease. The Game Genie cannot be used unless it is physically attached to a video game cartridge and then inserted into an NES control deck.

During the Game Genie's set-up mode, a display appears on the television screen and the player is presented with the choice of entering from one to three codes into the Game Genie. Each code can be six to eight letters in length, and each letter may be chosen from among sixteen available letters of the alphabet. Although there are billions of possible codes, a maximum of three codes can be entered for any single play of a game. When code selection is complete, the player presses the "select" button on the controller, the set-up mode screens display disappears, and the Game Genie shifts into its "game play mode." In this mode, the game begins, and the player plays the game with the alterations allowed by the Game Genie codes the player has entered. If no code has been entered, the Game Genie has no influence on game play, and the game plays exactly as it would if no Game Genie were attached.[2]

If the game player inputs one, two, or three codes into the Game Genie, each entered code causes the CPU to receive different data than it would if the Game Genie were not attached and activated by the game player.

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[2] The Game Genie interprets each of the codes a player selects to refer to a particular "address" in the game cartridge program ROM and the data that are stored there. As the game proceeds, the CPU inquiries that are directed to the game cartridge's program ROM pass through the Game Genie. If an inquiry is directed to an address that matches one of the codes the player has selected, the Game Genie substitutes the data it has stored for the data that the game cartridge would otherwise transmit to the CPU. (For example, assume the CPU asks for the initial number of lives and the game cartridge has the number "three" at the address corresponding to initial "lives." If the player has selected a code for six lives, the Game Genie would substitute data signifying six lives and send that data to the CPU.)

Each Game Genie code can substitute only a single byte of data at a single address. Thus, of the million or so inquiries per second that the CPU directs to the game cartridge, the Game Genie can interrupt and change relatively few.

Galoob has prepared a booklet intended to be distributed with the Game Genie entitled "Programming Manual and Code Book" ("Code Book"). The Game Genie Code Book instructions expressly encourage players to alter listed codes and to create various effects by programming their own codes. The effects of all codes, whether devised by Galoob or by the players themselves, are temporary in nature, and will last only until the player unplugs the game or resets in order to start a new game.

There are approximately 1,660 listed codes in the Game Genie code book, allowing various categories of temporary changes to be created with the use of the Game Genie. Some permit the player to choose where to begin the game, i.e. at a higher level of the game rather than at the beginning. Other codes allow the player to increase or decrease the number of chances the player has to complete the game or the amount of time in which those chances can be exercised. Others allow a player to advance more quickly through the game by skipping certain obstacles.[3]

The Game Genie cannot be used to play or do anything unless a separate game cartridge is also used. It can neither substitute for an NES game cartridge, nor can it reproduce or copy an independent version of the game. The effects of the Game Genie last only for the temporal period in which a particular sequence of play continues. Its effects vanish as the player ends a sequence of play by disconnecting the power to the game or by resetting and starting over. The Game Genie codes cannot change the plot, theme, or characters of any game. The vast majority of the Game Genie codes alter the rules of the game or method of play. *See infra* at 18-19.

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[3] Such effects are paralleled by Nintendo's hardware, pass-words, and "secrets," discussed *infra* at 35.

The Game Genie is marketed for use by consumers as an accessory to their home video system. It is not intended to be used in connection with any public performance of a video game, e.g. in an arcade setting. *Cf. Midway Mfg. Co. v. Artic Int'l. Inc.*, 704 F.2d 1009 (7th Cir. 1983), *cert. denied*, 464 U.S. 823 (1983). No evidence was presented of any such actual or potential public performance.

II. SCOPE OF COPYRIGHT PROTECTION

Article I, Section 8, of the Constitution provides: "The Congress shall have Power . . . To promote the Progress of Science and useful Arts by securing for limited Times to Authors and Investors the exclusive Right to their respective Writings and Discoveries." As new technological developments have occurred, Congress has responded by fashioning new rules of copyright.

Copyright protection is statutory, and the judiciary has shown a general reluctance to expand those protections, absent explicit legislative guidance. *See, e.g., Teleprompter Corp. v. Columbia Broadcasting System, Inc.*, 415 U.S. 394, 414 (1974). While there are sound historical and policy reasons for this consistent deference to Congress, Congress cannot immediately respond to each invention that hits the market. The courts must therefore use their best judgment to construe the meaning of certain words consistent with Congressional intent. *Sony Corp. v. Universal City Studios, Inc.*, 464 U.S. 417, 456 (1984).

Copyright protection does not accord a copyright owner complete control over all possible uses of the protected work. As stated in *Sony*, 464 U.S. at 429:

> The monopoly privileges that Congress may authorize are neither unlimited nor primarily designed to provide

> a special private benefit. Rather, the limited grant is a means by which an important public purpose may be achieved. It is intended to motivate the creative activity of authors and inventors by the provision of a special reward, and to allow the public access to the products of their genius after the limited period of exclusive control has expired.

Congress appears to have made reward to Nintendo a consideration of the copyright law, but not the only one.

A. Derivative works

The Copyright Act gives the holder exclusive rights to use and authorize the use of the work in five qualified ways, including the preparation of derivative works based upon the copyrighted work. 17 U.S.C. § 106(2). Nintendo alleges that the Game Genie is a derivative work. This Court does not agree.

Section 101 of the 1976 Copyright Act defines a derivative work as "a work based upon one or more preexisting works such as a translation, musical arrangement, dramatization, fictionalization, motion picture version, sound recording, art reproduction, abridgement, condensation, or *any other form* in which a work may be recast, transformed, or adapted" (emphasis added).

Nintendo relies heavily on *Midway Mfg. Co. v. Artic Int'l., Inc.*, 704 F.2d 1009 (7th Cir. 1983), *cert. denied*, 464 U.S. 823 (1983) in claiming that the Game Genie is a derivative work. That reliance is misplaced. As *Midway* noted, "It is not obvious from [the language of section 101] whether a speeded up video game is a derivative work." *Id.* at 1014. If it was doubtful as to whether or not the product in that case was a derivative work, the uncertainty is far greater regarding the Game Genie. In *Midway*,

the allegedly infringing product was a printed circuit board which could be used to speed up the rate of play - how fast the sounds and images changed - of one of plaintiff's video games ("Galaxian"), licensed for use in a play-for-pay arcade setting. Under those circumstances, the Seventh Circuit found that speeding up that specific game increased the licensee's revenue by making the game more challenging and decreasing the time it took to complete a game, i.e., more games could be played in a given time period, generating more income for the licensee. Acknowledging that the copyright owners of that video game would be anxious to obtain that extra revenue, the court found that commercial licensees were not implicitly authorized to use the speeded up circuit boards; therefore, the suppliers of those circuit boards contributorily infringed because the speeded version of the game was a derivative work. 704 F.2d at 1014.

Based on those facts, *Midway* held that the "amount by which the language of section 101 *must be stretched* to accommodate speeded up video games is . . . within the limits with which Congress wanted the new act to operate." *Id.*, (emphasis added). The result appeared to be based on the equities of that situation. Under those facts, the court was willing to "stretch" the acceptable definition of a derivative work. *Midway's* result, if not its analysis, appears to have turned on the fact that the licensee arcade owner, not the copyright holder, was making money from the public performance of the altered game, a violation of section 106(4) (copyright holder has exclusive right "to perform the copyrighted work publicly").[4]

The alleged infringer in this case is not a commercial licensee, but rather a consumer utilizing the Game Genie for

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[4] This Court expresses no view as to whether commercial arcade use of the Game Genie would be an unauthorized showing under section 106.

noncommercial, private enjoyment. Such use neither generates a fixed transferable copy of the work, nor exhibits or performs the work for commercial gain. *See* §§102, 106(4).

Whether or not video games modified by the Game Genie constitute derivative works is a difficult question. Viewing the Copyright Act as a whole, however, and considering the policies behind that Act, this Court concludes that inherent in the concept of a "derivative work" is the ability for that work to exist on its own, fixed and transferable from the original work, i.e., having a separate "*form*". *See* § 101 (derivative work definition). The Game Genie does not meet that definition.

As explained *supra*, a Game Genie allows a player to choose one to three modifications in the rules of a game, during a limited sequence of play. Once the Game Genie and its attached game cartridge are disconnected from the NES, or the power is turned off, those changes disappear and the video game reverts to its original form. No independent, fixed work is created.

In construing the phrase "derivative work" in light of technological change which has rendered its literal meaning ambiguous, the Court looks to the "basic purpose" of the Copyright Act - balancing a fair return on an author's creative labor against the need for "broad public availability of literature, music, and the other arts." *Twentieth Century Music Corp. v. Aiken*, 422 U.S. 151, 156 (1975). The Game Genie is a tool by which the consumer may temporarily modify the way in which to play a video game, legally obtained at market price. Any modification is for the consumer's own enjoyment in the privacy of the home. Such a process is analogous in purpose, if not in technology, to skipping portions of a book, learning to speed read, fast-forwarding a video tape one has purchased in order to skip portions one chooses not to see, or using slow motion for the

opposite reasons. None of those practices permanently modifies or alters the original work, none produces a separate work which can then be transferred in any way, none replaces the original work, and none deprives the copyright holder of current or expected revenue.

Both parties agree that it is acceptable, under the copyright laws, for a noncopyright holder to publish a book of instructions on how to modify the rules and/or method of play of a copyrighted game. Once having purchased, for example, a copyrighted board game, a consumer is free to take the board home and modify the game in any way the consumer chooses, whether or not the method used comports with the copyright holder's intent. The copyright holder, having received expected value, has no further control over the consumer's private enjoyment of that game.

Because of the technology involved, owners of video games are less able to experiment with or change the method of play, absent an electronic accessory such as the Game Genie. This should not mean that holders of copyrighted video games are entitled to broader protections or monopoly rights than holders of other types of copyrighted games, simply because a more sophisticated technology is involved. Having paid Nintendo a fair return, the consumer may experiment with the product and create new variations of play, for personal enjoyment, with-out creating a derivative work. *Cf. Midway*, 704 F.2d at 1013-14 (arcade use is a derivative work, because "[v]ideo game copyright owners would like to lay their hands on some of that extra revenue").

For these reasons, this Court finds that the Game Genie does not create a derivative work protected by the copyright laws.

B. Fair use.

Had the Court found that the Game Genie was a derivative work, Galoob would still be exempt from liability under the doctrine of "fair use." In making this finding, the Court has relied extensively on *Sony v. Universal, supra*, as well as the trial court's opinion in that matter.

As the Supreme Court stated in *Sony*, "[a]ny individual may reproduce a copyrighted work for a 'fair use'; the copyright owner does not possess the exclusive right to such a use." 464 U.S. at 433. "The doctrine of fair use allows a holder of the privilege to use copyrighted material in a reasonable manner without the consent of the copyright owner." *Narell v. Freeman*, 872 F.2d 907, 913 (9th Cir. 1989). Determination of fair use requires analysis under an "equitable rule of reason." *Sony*, at 464 U.S. at 448 (quoting H.R. Rep. No. 94-1467, *reprinted* in 1976 U.S. Code Cong. & Admin. News at 5679). "The copyright law, like the patent statutes, makes reward to the owner a secondary consideration." *Sony*, 464 U.S. at 429 (quoting *Fox Film Corp. v. Doyal*, 286 U.S. 123, 127 (1932)).

Sony - the only pronouncement by the Supreme Court on fair use in the contributory infringement context - involved facts analogous to those here. In *Sony*, holders of copyrights for certain television programs sued the manufacturer of the Betamax video tape recorder (video cassette recorder, or VCR) for contributory infringement. Those copyright holders (like Nintendo) sought to enjoin Sony (like Galoob) from manufacturing and selling an electronic device, claiming that purchasers of that device were using it to infringe copyrights. One use of the device was recording unauthorized copies of copyrighted television programs to "time shift" on-the-air broadcasts. The Supreme Court found

the consumers' use of Sony's product for time shifting purposes to be a "fair use" of the copyrighted programs.

Fair use is a privilege against a direct infringement claim (17 U.S.C. §107), and is a privilege held in the first instance by the alleged direct infringer - *i.e.*, by the person playing the video game. Just as application of the fair use doctrine in *Sony* resulted in substantial economic gain for Sony and other VCR manufacturers, the fair use doctrine applied to this case will benefit Galoob. *Sony* makes clear, however, that it is the fairness of the *family's* use of its video game, not some evaluation of the commercial "fairness" of Galoob's product, that must guide the Court's analysis.

In examining the fairness of the family's use, the Court is guided statutorily by 17 U.S.C. §107, through which Congress, in 1976, codified the common law doctrine of fair use.[5] Section 107 enumerates four non-exclusive "factors to be considered" in assessing fair use; they are intended to guide but not to limit analysis. H.R. Rep. No. 94-1476 at 5680; *see also Harper & Row Publishers*, 471 U.S. at 539, 560 (1985) (four factors "not meant to be exclusive"). In determining whether the use made of a work in any particular case is a fair use, the factors to be considered shall include:

(1) the purpose and character of the use, including whether such use is of a commercial nature or is for nonprofit educational purposes;

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[5] That statute was merely "intended to restate the present judicial doctrine of fair use, not to change, narrow or enlarge it in any way." H.R. Rep. No. 94-1476, *supra*, at 5680. Congress had "no disposition to freeze the doctrine in the statute, especially during a period of rapid technological change." *Id.*

(2) the nature of the copyrighted work;

(3) the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and

(4) the effect of the use upon the potential market for or value of the copyrighted work.

1. The First Factor: A Family's "Non-Commercial" Home Use Of Its Video Games Creates A Presumption Of Fair Use.

The first factor is "the purpose and character off the use, including whether such use is of a commercial nature or is for nonprofit purposes." 17 U.S.C. §107(1). If the consumer were making a commercial or profit-making use of the copyrighted work, that use would be presumptively unfair. *Sony*, 464 U.S. at 449. "The contrary presumption is appropriate here, however, ... because time-shifting for private home use must be characterized as a non-commercial, nonprofit activity." *Sony*, 464 U.S. at 449. Likewise, a family's use of a Game Genie for private home enjoyment must be characterized as a non-commercial, nonprofit activity. The game owner is simply playing the game purchased for personal enjoyment, not exploiting the game in some commercial venture. The first factor therefore establishes a presumption of fair use, which could be overcome only by Nintendo's direct proof of injury.[6]

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[6] Although Nintendo emphasized the "productive use" doctrine, *Sony* minimized the importance of that doctrine by reversing the Ninth Circuit's conclusion that time-shifting "was not a fair use because it was not a 'productive use.'" *Sony* 464 U.S. at 427; *see also Fisher, Reconstructing The Fair Use Doctrine*, 101 Harv. L. Rev. 1661, 1684 (1988) ("The most dramatic change wrought by *Sony* and *Harper & Row* in the fair use doctrine was the subordination of the idea of productivity").

The *Midway* decision does not analyze the commercial use of such products *vis-a-vis* private home use. By contrast, this Court finds a convincing and persuasive analogy in the trial court's analysis of legislative intent in *Universal City Studios v. Sony Corp. of America*, 480 F. Supp. 429 (C.D. Cal. 1979). That court, in discussing whether or not home recording of copyrighted works violated the Copyright Act, quoted the following from the House Report accompanying the 1971 Amendment:

"Specifically, it is not the intention of the Committee to restrain the home recording, from broadcasts or from tapes or records, of recorded performances, where the home recording is for private use and with no purpose of reproducing or otherwise capitalizing commercially on it." H. Rep. No. 487, 92nd Cong., First Sess. 7, *reprinted in* 1971 U.S. Code Cong. & Admin. News at 1566-1572.

Further citations to the Congressional Record acknowledged a reluctance to interpret or enforce the Copyright Act by carrying copyright protection into the home or by banning devices for off-the-air recording. *Id.*, at 445. While the Game Genie is a different device than a video home recorder, it involves the same policy decision, i.e., whether Congress wishes to carry copyright enforcement into the home.

2. The Second Factor: The Published "Nature" Of Video Games Supports Fair Use.

The second factor considers "the nature of the copyrighted work." 17 U.S.C. §107(2). The courts have traditionally inquired whether the work is published, with unpublished works gaining more protection. 3 Nimmer §13.05[A][2], at 13-75 to 13-79. "The fact that a work is unpublished is a critical element of its 'nature'" suggesting that pre-publication exploitation of the work would be

unfair. *Harper & Row*, 471 U.S. at 564 (unfair to scoop key excerpts of unpublished manuscript without author's consent). By contrast, Nintendo has already published millions of copies of its games to anyone willing to pay the purchase price. Only after acquiring a published copy of the game may its owner use it in combination with the Game Genie. The works' published nature supports the fairness of the use.

3. The Third Factor: Because Game Owners Have The Right To Use The Games They Purchase, Their Use Does Not Weigh Against Fair Use.

The third factor in the fair use analysis is the "amount and substantiality of the portion used in relation to the copyrighted work as a whole." 17 U.S.C. §107(3). Again, the *Sony* decision is dispositive. *Sony* recognized that the reproduction of an entire work ordinarily weighs against the claim of fair use. 464 U.S. at 450. In *Sony*, however, because the VCR owner "had been invited to witness [the television program] in its entirety free of charge, the fact that the entire work is reproduced does not have its ordinary effect of militating against a finding of fair use." *Id.* at 449. Likewise, in this action a game owner who has fairly acquired a Nintendo game has a right to use the entire work. The game owner's rights are equal to, if not greater than, those of the user in *Sony*, who did not pay for the product being used. Because the game owner is entitled to use the entire work, no matter what the "amount and substantiality" of his use, the third factor cannot assist Nintendo in overcoming the presumption of fair use.

4. The Fourth Factor: Nintendo Has Not Proven Harm

The last and "undoubtedly the single most important" factor is the "effect of the use upon the potential market for or value of the copyrighted work." *Harper & Row*, 471 U.S. at 566; 17 U.S.C. §107(4). To defeat fair use under this factor "requires

proof either that the particular use is harmful, or that if it should become widespread, it would adversely affect the potential market for the copyrighted work." *Sony*, 464 U.S. at 451.

Nintendo bears the burden of proving that these particular uses will have an adverse effect on the market for the copyrighted Nintendo games. *Sony*, 464 U.S. at 451. It has not met that burden, for the reasons explained below.

a. Nintendo Has Not Shown That The Game Genie Supplants, Rather Than Suppresses, The Market For The Copyrighted Works.

The fourth fair use factor looks primarily to whether a use "supplants any part of the normal market for a copyrighted work." H.R. Rep. No. 83, 90th Congress, 1st Sess. 33, 35 (1967), as quoted in *Marcus v. Rowley*, 695 F.2d 1171, 1177 (9th Cir. 1983). Nintendo cannot demonstrate that use of the Game Genie "*fulfills the demand* for the originals of the copyrighted games at issue. *Fisher v. Dees*, 794 F.2d 432, 438 (9th Cir. 1986) (emphasis in original). Widespread use of the Game Genie cannot supplant the market for the games in suit. The Game Genie cannot operate without a game cartridge. Significantly, Nintendo does not contend that families will buy fewer new games because they are using their Game Genie with old ones. The Game Genie does not compete for sales with the original copyrighted works for which Nintendo claims infringement.

Nintendo's claim is that the Game Genie will *indirectly* harm its overall market because it will make people enjoy their games less, and thereby generally reduce demand for Nintendo's copyrighted games. Nintendo had the burden of proof on that issue and failed to meet it.

A fair use will frequently suppress demand for a work, but as long as it does so without supplanting demand, the indirect detrimental effect on the market is not the subject of copyright protection. An obvious example is an unfavorable book or movie review containing quotations from the copyrighted work, along with criticism which may suppress demand. This capacity to injure does not impede a finding of fair use. *See Fisher v. Dees*, 794 F.2d at 438. Another example is a parody, which "may quite legitimately aim at garroting the original, destroying it commercially as well as artistically." *Id.* at 437. As the Ninth Circuit holds, however, "the economic effect of [the use] with which we are concerned is not its potential to destroy or diminish the market for the original - any bad review can have that effect - but rather whether it *fulfills the demand* for the original. Biting criticism suppresses demand; copyright infringement usurps it." *Id.* at 438 (emphasis in original).

The Second Circuit applied this principle in *Consumers Union of U.S. Inc. v. General Signal Corp.*, 724 F.2d 1044 (2d Cir. 1983), *cert. denied* 469 U.S. 823 (1984). There, defendant's advertisements quoted the favorable rating of its product by Consumer Reports, a copyrighted magazine. In an argument reminiscent of Nintendo's claim that it will lose "goodwill" as a result of the Game Genie, Consumer Reports alleged that the value of its magazine was diminished because its reputation for independence would suffer as a result of being perceived as endorsing defendant's product. The Second Circuit rejected plaintiff's argument in no uncertain terms:

> The Copyright Act was not designed to prevent such indirect negative effects of copying. The fourth factor is aimed at the copier who attempts to usurp the demand for the original work. The copyright laws are intended to prevent copiers from taking the owner's intellectual

> property, and are not aimed at recompensing damages which may flow indirectly from copying.

724 F.2d at 1051 (citations omitted).

Nintendo argues that its market may be affected by suppression of demand rather than supplanting of it. That injury, even if it were likely, does not defeat fair use.

b. Nintendo Has Not Shown Any Injury To The Relevant Market For The Copyrighted Works.

Nintendo has likewise failed to prove an adverse effect on the relevant market for the copyrighted works at issue. Most of Nintendo's original copyrighted works are no longer on the market, including the vast majority for which the Galoob Code Book lists codes. The Game Genie cannot affect sales of products no longer available.[7]

Nintendo also seeks relief for harm that may occur in the future, on the grounds that the Game Genie may decrease demand for sequels or slightly altered versions of Nintendo games. Nintendo has not, to date, issued or considered issuing altered versions of existing games. Nintendo argues, however, that should such a market develop within the copyright period, it is entitled to decide if such games are appropriate and to reap the resulting revenues. In theory, Nintendo is correct; however, it has failed to show the reasonable likelihood of such a market. Nintendo's video games are expensive toys; each retails in the $40 to $50 range. There is neither evidence nor reason to believe that a consumer

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[7] Furthermore, even if the Game Genie published code books for up-to-the-minute games, Nintendo has not shown that consumers would be *less* likely to buy the games simply because code books for current games were available.

who owns the original game would invest a similar amount in a slight variation thereof.

In addition, Nintendo's assertion that it may wish to re-release altered versions of the games in suit 10, 20 or 30 years from now (much as Parker Brothers recently did with "Monopoly") is at odds with the position taken by Nintendo in various other lawsuits pending before this Court. In those actions, Nintendo opposes antitrust claims by using the vagaries of the video game industry to rebut the impact and permanence of its market control, if any. Having indoctrinated this Court as to the fast pace and instability of the video game industry, Nintendo may not now, without any data, redefine that market in its request for the extraordinary remedy sought herein. Nintendo has failed to show any harm to the present market for its copyrighted games and has failed to establish the reasonable likelihood of a potential market for slightly altered versions of the games at suit. While good board games may never die, good video games are mortal.

c. Nintendo Has Not Shown That Any Uses Of The Game Genie Would Have A Deleterious Effect On Sales.

The only empirical evidence of market reaction to the Game Genie is the Canadian study, which indicates that the Game Genie will enhance, not detract from, Nintendo's sales. *See Sony*, 464 U.S. at 423-24, 452-53, n.36-37 (relying on consumer survey to determine market impact). During February of this year, 6 months after introduction of the Genie in Canada, a market research firm polled 300 Canadian owners of the Game Genie, aged 8 or older.

The survey failed to reveal any detrimental effect to the Nintendo market.[8]

Nintendo objected to the survey on various grounds, including the fact that Canadians, not Americans, were polled. Nintendo's criticisms go to the weight of the survey, not its admissibility. Nintendo offered no meaningful evidence that consumer research in the United States is performed differently from that conducted in Canada, or that consumers who play video games in the United States have different tastes or attitudes than do video game players in Canada. Nintendo has access to its own sales data for the nine months Game Genie has been on sale in Canada. Nevertheless, it produced neither statistical evidence of lost sales nor any Canadian retailer testimony of adverse impact from Game Genie on the demand for Nintendo games. The Court is influenced by Nintendo's failure to proffer any empirical evidence of a negative market impact or potential impact from the Game Genie. The only reasonable inference for the trier of fact is that no such impact exists.

Nintendo failed to take advantage of other opportunities to show lost sales. For instance, Nintendo uses ongoing focus groups as part of its continuing marketing and quality control. It could have used those groups to test the effect of Game Genie use on attitudes about Nintendo games. It did not. Since Nintendo had the

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[8] 72% of the respondents believe that the Game Genie makes video games more fun. 45% enjoy playing their games more than before they had a Game Genie, 53% enjoy their games the same, only 2% enjoy their games less.

52% are more interested in buying new video games since they have had the Game Genie, and only 2% are less interested.

29% of the respondents play their Nintendo games more often than before they had a Game Genie, 67% play their games the same amount, and only 4% play their games less often.

incentive, opportunity and ability to proffer such evidence, its failure to do so gives rise to the contrary inference, i.e., that there are no material differences between the Canadian and American markets, and that the Game Genie has had no detrimental impact on Nintendo's sales in Canada.

Galoob's evidence on sales was persuasive. In additional [sic] to the survey data, Galoob proffered expert testimony from Glenn Rubenstein, a member of Nintendo's "target" market (males between 8 and 14 years old). He has been a serious player of video games for several years and spends as many as 30 hours per week with this avocation. He has written numerous magazine and newspaper articles critiquing variouS video games, including Nintendo's. Rubenstein's opinion is that the Game Genie would encourage rather than discourage enthusiasm over video games in general, because it allows players to explore new ways of playing a game, thereby making the game more accessible to players of differing abilities. This would likely increase the use of a video game in a multi-player family, providing more value per consumer dollar. The Court found his testimony more convincing than that of Nintendo's employees and experts.

For these reasons, the Court is unconvinced that the Game Genie will decrease Nintendo's sales.

d. Harm To The Nintendo Culture Is Not Cognizable Under Copyright Law.

Nintendo's main objection to and claimed damage from the Game Genie is the potential detriment to the "Nintendo Culture," a concept discussed at length by Nintendo's attorneys and witnesses. This culture, the apex of Nintendo's marketing strategy, is a mind-set intentionally created by Nintendo in its consumers. Like most cults, fads or addictions, it thrives when fueled by

constant peer pressure. Nintendo fears that, by allowing users to change the rules of Nintendo games, the Game Genie will upset the inculturation process that Nintendo has designed into its products, thereby lessening the value of membership in "the culture" and reducing product loyalty. Having rescued the video game industry from the shambles of the early 1980's, Nintendo argues that it is now entitled to decide how its games should be enjoyed, by whom, and under what circumstances, even after the consumer has paid full price.

According to Nintendo, the Game Genie will harm the Nintendo culture in two distinct ways. First, it argues that the use of the Game Genie allows players to modify Nintendo's carefully crafted games in such a way that ultimate user satisfaction will be diminished, leading to an over-all decline in the video game industry. Nintendo called several witnesses, including its own game designers and two behavior modification psychologists, each of whom opined that 1) Nintendo's games are designed to provide ultimate satisfaction; 2) tampering with Nintendo's design in any way thwarts the "challenge of the game", or its "playability", thereby resulting in lesser enthusiasm for video games in general, and Nintendo games in particular; and 3) this reduced enjoyment may lead to the drastic decline in the video game market similar to that which occurred in the early 1980's, even if it does not diminish revenue for the particular games in suit.[9] Neither the

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[9] For instance, Nintendo's expert Professor Gregory Loftus declared:

> The majority of Nintendo's players belong to a loose sodal confederation that might collectively be called the 'Nintendo culture.' This culture includes talking about Nintendo video games with friends, comparing scores and achievements,... and getting high scores published. The operation of the Nintendo culture rests entirely on the games being challenging. . . .
> Being part of the Nintendo culture would no longer be enjoyable or meaningful, and sales of Nintendo video games would decline. ... Were

Nintendo employees nor the behaviorists provided empirical data upon which to support the claim that Nintendo is better able to judge when a player is having fun than is the player herself.

There is no doubt that Nintendo revitalized the video game industry, nor is there any doubt that it produces a carefully controlled and well-made product which is impressively marketed. Nevertheless, those achievements do not give Nintendo a right to expand its copyright protection beyond that granted under the copyright laws.

Moreover, Nintendo's argument that any device that makes game play easier will injure its market for video games is undermined by its own behavior. It is significant that Nintendo markets publications and devices that make similar modifications available. For example, Nintendo publishes "passwords" enabling game owners to start game play at different levels or worlds and with different powers. Nintendo Power magazine[10] contains "secret" codes which allow game owners to skip to portions of games they enjoy, or to gain additional lives. Nintendo also markets an interactive device called the "NES Advantage," which can substitute for the controller included with the standard Nintendo system. Among the advantages that NES Advantage provides are the options of slow motion play and extra fire power to make game play easier. These are similar to options that Game

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Game Genie use [sic] to become prevalent, the photographing of a particular screen [to show a high score] would not be indicative of any skill or achievement, and this socially-reinforcing practice would fall by the wayside.

G. Loftus narr. stmnt at 3; *see also* P. Main narr. stmnt at 3; H. Lincoln narr. stmnt at 17; H. Phillips narr. stmnt at 6.

[10] The magazine is copyrighted by Nintendo of America.

Genie makes available to players. The fact that Nintendo offers consumers the ability to temporarily alter the images of their games undercuts Nintendo's arguments that such alterations are likely to create disincentive for the purchase of additional video games. If Nintendo believed this, it would not market accessories which it feared would lead to the demise of its multibillion dollar share of the video game industry.[11]

Nintendo has attempted to achieve in this litigation what it could not achieve in the market - the "exclusive right to modify game play as it alone sees fit and to maintain game play in its original state." Nintendo's Reply Memo. In Supp. Prelim. Injunc. at 17-18. This Court does not interpret the Copyright Act as bestowing such broad monopoly powers. The Copyright Act protects authorship, not market psychology.

5. Fair Use Summarized.

To summarize the four fair use factors, then, the non-commercial nature of the player's home use of the Game Genie creates a presumption of fair use under *Sony*. The published nature

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[11] Indeed, Nintendo's chief marketing officer, Peter Main, contradicts the theory that Nintendo asserts in this case. In the analysis he presented at a 1989 Nintendo sales meeting, Mr. Main stated:

> Let's not forget that key category called accessories. Good accessories are important for several reasons including . . . because *they give added value to our software by giving a NES player a whole new experience and sense of game play* when he replays a piece of software with one of the accessor[ies]. *And all that adds up to increased consumer satisfaction which brings them back for more.* Two of the strongest performers in this regard are the Max and Advantage controllers. . . .

Text of speech delivered at the 1989 SCES sales meeting, June 2, 1989, Ex. G-364 (emphasis added).

of video games supports the fairness of a consumer's transitory alterations of those images. Because the game owner has the indisputable right to use his or her entire game, the amount of his or her use cannot weigh against fairness. Further, Nintendo has failed, in three respects, to carry its burden to prove injury: It has not shown that any use supplants demand for its works, that any actual or reasonably likely market is injured, or that use of the Game Genie in ways that arguably infringe Nintendo's copyrights would diminish the overall demand for Nintendo games. Lacking proof that either actual or likely markets for the copyrighted works are liable to be affected, Nintendo has failed to satisfy the fourth fair use factor.

In short, even were the Court to find that the use of the Game Genie allows players to produce a derivative work, the shield of fair use is available and would provide a complete defense to any claim of direct infringement against the game players. Absent direct infringement, there is no contributory infringement.

III. DIRECT INFRINGEMENT

Because the Game Genie does not create a derivative work when used in conjunction with a copyrighted video game, Galoob does not "authorize the use of a copyrighted work without actual authority from the copyright owner." *Sony*, 464 U.S. at 435 n.17. All of the cases Nintendo cites on this point deal with unauthorized public performances for profit, § 106(4), not private, non-commercial use. Further, Galoob is not liable as a direct infringer for testing, demonstrating, and marketing the Game Genie, or for developing codes for use with the Game Genie.

IV. INJUNCTIVE RELIEF

Even had this Court found that the Game Genie infringes Nintendo's copyrights, a permanent injunction in favor of Nintendo would not be the appropriate remedy because:

1) Any presumption of immediate and irreparable harm resulting from the alleged infringement was rebutted;

2) The presence of the Game Genie in the market benefits the public by expanding personal consumer utilization of purchased games; and

3) Assuming infringement, adequate remedies exist at law.

CONCLUSION

For the reasons stated above, the Court orders declaratory relief as follows: (1) the use of a Game Genie by consumers, for non-commercial use, does not violate Nintendo's rights under the Copyright Act of 1976; and (2) Galoob is neither a contributory nor a direct infringer.

The pending preliminary injunction enjoining Galoob from exercising all commercial activities associated with its license for the Game Genie should be and is hereby DISSOLVED.

This Court will not stay the lifting of the injunction, pending appeal, because further equitable relief for Nintendo is unwarranted. Any request for a stay should be addressed to the Ninth Circuit Court of Appeals.

The parties are ordered to appear before this Court on Monday, August 19, 1991 at 2:30 p.m., to discuss further proceedings in this matter.

SO ORDERED.

DATED: July 12, 1991

/s/ Fern M. Smith
FERN M. SMITH
United States District Judge

(The decision of the Court is referenced in a "Table of Decisions Without Reported Opinions" appearing in the Federal Reporter [923 F.2d 862].)

NINTENDO OF AMERICA INC., a Washington corporation, Plaintiff-Appellee,

v.

LEWIS GALOOB TOYS, INC., a Delaware corporation, Defendant-Appellant.

No. 90-15936.

United States Court of Appeals, Ninth Circuit.

Argued and Submitted Sept. 12, 1990.

Decided Jan. 24, 1991.

Appeal from the United States District Court for the Northern District of California, No. CV-90-1586 RHS; Robert H. Schnacke, District Judge, Presiding.

AFFIRMED.

Before FLETCHER, BOOCHEVER and WIGGINS, Circuit Judges.

MEMORANDUM

Lewis Galoob Toys, Inc. ("Galoob") appeals the district court's grant of a preliminary injunction in favor of Nintendo of

America, Inc. ("Nintendo"), enjoining Galoob from producing or marketing its product, the Game Genie. We have jurisdiction pursuant to 28 U.S.C. § 1292(a)(1). We affirm.

Nintendo makes and sells the Nintendo Entertainment System, a home video game system. To use the system, a player inserts into the system's control deck a cartridge containing one of the games that Nintendo produces or licenses others to produce. The game is then displayed on a connected television screen. By moving buttons and a joystick on the controller, the player controls the actions of one of the game's characters and progresses through the video game.

The Game Genie is a hardware device manufactured by Galoob that can be attached to a game cartridge before it is inserted into the Nintendo control deck. The Game Genie allows the player to alter certain features of the Nintendo game by choosing up to three codes from a large number of Game Genie codes. For each of the codes entered by the player, the Game Genie blocks the value for a single data byte sent by the game cartridge to the central processing unit in the Nintendo controller and replaces it with a new value. For example, if the cartridge sends a data byte setting the number of lives for the player's character at 3, the Game Genie might, depending on the codes chosen by the player, substitute the value 6, thereby giving the character 6 lives rather than 3 in which to complete the game. The player can also change the color of certain features of the audiovisual display, change the speed at which the character moves, allow the character to float above obstacles and alter myriad other features of the Nintendo game.

The Game Genie makes no change in the data stored in the game cartridge. Its interception and substitution of data takes place only as long as it is attached to the game cartridge and the

controller's power is on. The individual changes that the user makes through entering codes therefore alter the audiovisual display temporarily but do not change it or the Nintendo game permanently.

Nintendo contends that the alterations made by Game Genie to the audiovisual displays of its games violates its copyrights. It contends that Game Genie alters the audiovisual expression in these games, in violation of Nintendo's exclusive rights to control derivative works. On issuing the preliminary injunction below, the district court accepted Nintendo's arguments, finding that Nintendo would likely prevail on the merits of its claim that Galoob had infringed on Nintendo's copyright and that the balance of hardships tipped decidedly in Nintendo's favor.

Our review of a preliminary injunction is limited. *Johnson Controls, Inc. v. Phoenix Control Sys.*, 886 F.2d 1173, 1174 (9th Cir. 1989). We review *de novo* the correctness of the legal standards employed by the district court in evaluating the plaintiff's likelihood of success on the merits. *Dumas v. Gommerman*, 865 F.2d 1093, 1095 (9th Cir. 1989). However, we will reverse the district court's issuance of a preliminary injunction only if the district court abused its discretion, or based its decision on an erroneous legal standard or clearly erroneous findings of fact. *Johnson Controls*, 886 F.2d at 1174; *Dumas*, 865 F.2d at 1095. We will not reverse merely because we would have reached a different result from that reached by the district court. *Big Country Foods, Inc. v. Board of Educ.*, 868 F.2d 1085, 1087 (9th Cir. 1989).

To sustain the grant of the preliminary injunction, we must find that the district court did not abuse its discretion in determining that Nintendo showed either a likelihood of success on the merits and the possibility of irreparable injury, or that serious

questions going to the merits were raised and the balance of hardships tipped sharply in its favor. *Johnson Controls*, 886 F.2d at 1174. The test for granting a preliminary injunction is viewed as a continuum in which the degree of irreparable harm required increases as the probability of success on the merits decreases. *Id.*; *Dumas*, 865 F.2d at 1095. Thus, "[i]f the balance of harm tips decidedly toward the [moving party], then the [moving party] need not show as robust a likelihood of success on the merits as when the balance tips less decidedly." *Brenda v. Grand Lodge of Int'l Ass'n of Machinists*, 584 F.2d 308, 315 (9th Cir. 1978).

In the district court, the only issues raised and discussed by Galoob as defenses to Nintendo's copyright infringement claim were: (1) whether use of the Game Genie failed to constitute an unauthorized derivative work because Nintendo had authorized users to alter the audiovisual displays in the manner effected by the use of the Game Genie and; (2) whether 17 U.S.C. § 117 provides a defense to the infringement charge. On appeal, Galoob does not raise the issue of Nintendo's authorizing users to make the changes made by the Game Genie. Along with its claim that 17 U.S.C. § 117 provides a defense, Galoob raises other issues on appeal, including: (1) whether the Game Genie's alterations to the Nintendo games were "fixed" within the meaning of 17 U.S.C. § 101 in order to constitute a derivative work; (2) whether the Game Genie alters only concepts or rules of Nintendo's games, which as ideas are not protectable; (3) whether the audiovisual works as altered by the Game Genie meet the originality requirement for derivative works; (4) whether the game owner's use of the Game Genie to play Nintendo games is a noninfringing fair use; (5) whether the Game Genie has substantial noninfringing uses and therefore cannot constitute contributory copyright infringement; and (6) whether Galoob cannot be found to have committed contributory infringement because Nintendo does not

speak for virtually all copyright holders with an interest in the outcome.

As a general rule, a federal appellate court will not review issues on appeal not raised in the court below. E.g., *Brown v. Civil Serv. Comm'n*, 818 F.2d 706, 710 (9th Cir. 1987). Galoob argues that we should consider those issues first raised on appeal on the basis of the exception to this rule that allows consideration of issues of law that do not require factual determinations beyond those in the record. *See id.* We decline to apply this "narrow and discretionary" exception for several reasons. *Jovanovich v. United States*, 813 F.2d 1035, 1037 (9th Cir. 1987). First, in the absence of compelling reasons to do so, we are unwilling to expand our consideration beyond issues that were before the district court on review of an interlocutory appeal of a preliminary injunction. Unlike review of a final judgment where, if this court were to refuse to address issues not raised below they might never be addressed, the district court will have the opportunity to consider these issues when deciding the merits of the parties claims. Second, most of the issues not raised below by Galoob, specifically issues (2)-(6), require findings of fact not made by the district court. While issue (1) conceivably could be decided on the basis of the existing record, the exception for issues of law "necessarily applies only when the party against whom the issue is raised would not be prejudiced and would not have tried his case differently either by developing new facts in response to or advancing distinct legal arguments against the issue." *Brown v. Civil Serv. Comm'n*, 818 F.2d at 710 (quoting *United States v. Gabriel*, 625 F.2d 830, 832 (9th Cir. 1980), *cert. denied*, 449 U.S. 1113 (1981)). As it is possible that Nintendo could have raised factual and legal arguments below regarding Galoob's claim that the image produced by the Game Genie is not fixed, we decline to review this issue on appeal.

In reviewing the merits of Nintendo's claim of copyright infringement, we are persuaded that Nintendo raises a substantial question on the merits. Galoob does not contest Nintendo's ownership of copyrights to the audiovisual work embodied in the display of the video games. Section 106(2) of the Copyright Act of 1976, as amended, grants a copyright owner the exclusive right to prepare derivative works. 17 U.S.C. § 106(2). While we do not directly assess the strength of Galoob's arguments on appeal that the alterations produced by Game Genie fail to constitute a derivative work because the Game Genie's alterations are neither fixed nor original, we find that Nintendo raises substantial question on the basis of the record as a whole regarding whether use of the Game Genie creates unauthorized derivative works in violation of Nintendo's copyrights. Galoob's argument that 17 U.S.C. § 117 provides a defense to that claim is not so strong as to dispel that substantial question. Because we find that Nintendo raises a substantial question on the merits on the issue of whether Galoob's actions constitute direct infringement, we do not consider whether Nintendo raises a substantial question on the issue of whether Galoob's actions constitute contributory infringement.

We also find that the balance of hardships in this matter tips sharply in Nintendo's favor. A large portion of the harm to Galoob and Nintendo from either granting or denying the preliminary injunction would be financially compensable. However, Nintendo introduced evidence in the court below that the sale of Game Genie could cause irreparable harm to its design strategy, reputation, and its right to create derivative works. The district court did not abuse its discretion by finding that the balance of hardships tilted strongly in Nintendo's favor on this basis. See *Apple Computer, Inc. v. Formula Int'l Inc.*, 725 F.2d 521, 525-26 (9th Cir. 1984).

We AFFIRM the district court's grant of a preliminary injunction in favor of Nintendo.

Supreme Court, U.S.
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No. 93-2035

In the Supreme Court
OF THE
United States

OCTOBER TERM 1993

NINTENDO OF AMERICA, INC.,
Petitioner,

v.

LEWIS GALOOB TOYS, INC.,
Respondent.

Petition For A Writ Of Certiorari
To The United States Court Of Appeals
For The Ninth Circuit

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

Petitioner Nintendo claimed copyright infringement by, and obtained a preliminary injunction against, Respondent Lewis Galoob Toys, Inc. ("Galoob").[1] Nintendo posted a $15 million injunction bond. After a trial, the United States District Court denied a permanent injunction, finding no copyright infringement. The Ninth Circuit Court of Appeal's affirmed and that decision is now final. Thereafter, the District Court determined that Galoob was injured by the preliminary injunction in an amount exceeding $15 million and that it was entitled to execute on the security bond in the full amount. The Ninth Circuit affirmed. The questions presented are:

1. Did the Ninth Circuit apply an appropriate standard in holding that under Rule 65(c) of the Federal Rules of Civil Procedure, there is a rebuttable presumption in favor of execution on a preliminary injunction bond that can be rebutted by showing compelling equitable reasons against enforcement?

2. Did the Ninth Circuit fail to consider the equitable reasons asserted by Nintendo as a defense to enforcement?

3. Did the District Court and the Ninth Circuit abuse their discretion in determining that Nintendo had not demonstrated equitable circumstances sufficient to rebut the presumption in favor of enforcement?

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[1]All parties who appeared below are listed in the above caption. Pursuant to Supreme Court Rule 29.1, Respondent represents that it has no parent company. Respondent owns a one-third interest in Galoob Toys Canada, Inc., an Ontario corporation, and has no other affiliates or subsidiaries that are not wholly-owned.

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No. 93-2035

In the Supreme Court
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OCTOBER TERM 1993

NINTENDO OF AMERICA, INC.,
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LEWIS GALOOB TOYS, INC.,
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Petition For A Writ Of Certiorari
To The United States Court Of Appeals
For The Ninth Circuit

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

STATEMENT OF THE CASE

In the late 1980s and early 1990s, Nintendo made and successfully sold over 30 million video game machines to American consumers. Nintendo sold master game consoles, related software, and a variety of separately sold accessory products. In mid-1990, Galoob announced and displayed a new Nintendo-compatible accessory called the Game Genie. Within a few weeks, the video game magazines labelled the

Game Genie "the accessory of the year" and Galoob received 550,000 initial orders from retailers with promises of many more as Christmas approached. Nintendo sued, claiming copyright infringement, and sought and received a preliminary injunction which entirely prevented Galoob from manufacturing, marketing, and selling the Game Genie, or fulfilling any of its existing orders for the product.

As a result, Nintendo—for more than twelve months—enjoyed sales of its own video game accessories without competition from the Game Genie. By contrast, Galoob was left with a frozen inventory, an impaired reputation, and a layoff of valued employees. As required by Federal Rule of Civil Procedure 65(c), Nintendo posted security of $15 million to protect Galoob against losses sustained as a result of wrongful injunction.

After an expedited two-week trial on the merits, the District Court found that the Game Genie did not infringe Nintendo's copyrights. The Ninth Circuit Court of Appeals affirmed that judgment and this Court denied Nintendo's first Petition for Writ of Certiorari. After completion of extensive damage discovery and another trial in December 1991, the District Court found that Galoob had been wrongfully enjoined and found that Galoob had been damaged well in excess of the $15 million security in lost sales, interest, and miscellaneous manufacturing costs incurred as a result of the wrongful injunction. The District Court awarded $15 million to Galoob and, again, the Ninth Circuit Court of Appeals affirmed the judgment expressly adopting the prevailing standard of a rebuttable presumption in favor of bond execution.

Only by ignoring the express holding of the Ninth Circuit can Nintendo claim a four-way split among the Courts of Appeals in seeking review by this Court of what is in fact a completely straightforward judgment. Nintendo's Petition rests upon a material misstatement of the Ninth Circuit's decision. In fact, the Ninth Circuit did not create a new standard, but rather expressly followed the majority rule articulated by the District of Columbia and

Seventh Circuits in *National Kidney Patients Ass'n v. Sullivan*, 958 F.2d 1127, 1134 (D.C. Cir. 1992), *cert. denied*, 122 L. Ed. 2d 122 (1993) and *Coyne-Delany Co. v. Capital Development Board*, 717 F.2d 385, 391-92 (7th Cir. 1983):

> "This brings us to the next question: Is Galoob entitled to have the bond executed in its favor? Although there seems to be some variance in how other circuits respond to this question, *we join what appears to be the majority and hold there is a rebuttable presumption that a wrongfully enjoined party is entitled to have the bond executed and recover provable damages up to the amount of the bond*. . . . [T]his standard provides an equitable means by which courts can decline to impose damages on the rare party who has lost a case on the merits but nevertheless should not suffer the execution of the preliminary injunction bond." (*Lewis Galoob Toys, Inc. v. Nintendo of America, Inc.*, 16 F.3d 1032, 1036-37 (9th Cir. 1994) ("*Galoob II*") (Pet. App. A-12-13) (citations omitted) (emphasis added))

At bottom, Nintendo seeks review of the Ninth Circuit's *application* of that standard to the particular facts of this case. The question of whether the Ninth Circuit's balancing of the equities was an abuse of discretion does not merit review in this Court. This Court should deny the Petition and thus end Nintendo's legal campaign against a much smaller competitor, giving Galoob finality for a judgment of $15 million in lost profits that the District Court found will only partially compensate it for the harm it suffered as a result of the entry of the preliminary injunction.

A. Statement Of Facts.[2]

Nintendo entered the U.S. home video game market in 1986 when it introduced the "Nintendo Entertainment System" ("NES"). The NES consists of a dedicated computer housed in a "control deck," one or more video game cartridges that are inserted into the control deck during play of a game, and a player-held device for directing the motion of the game characters (a "controller"). CR 289 at 6. After introduction of the NES, Nintendo and a variety of software companies under license from Nintendo began to market games that were compatible with the NES. *Id.* at 7. In addition, a wide variety of different accessories, including controllers, were made and sold by Nintendo, its licensees, and independent companies for use with NES games. *Id.* at 7-8. Nintendo's commercially successful controllers included the "Advantage," one of a number of "joysticks" sold for the NES, and the "Max," an upscale "joypad," introduced in 1987 and 1988, respectively. CR 427 at 13.

In May 1990 Galoob announced a new accessory for the NES, called "Game Genie." In its opinion affirming the judgment that Galoob did not infringe Nintendo's copyrighted audiovisual works, the lower court described Game Genie as follows:

> "The Game Genie . . . allows the player to alter up to three features of a Nintendo game. For example, the Game Genie can increase the number of lives of the player's character, increase the speed at which the character moves, and allow the character to float above obstacles. The player

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[2]Nintendo has omitted any significant discussion of the judgment in Galoob's favor which resulted in the finding of wrongful preliminary injunction or the judgment that it suffered in excess of $15 million in damages; further, Nintendo has in some instances misdescribed the order of proceedings in the lower court beyond recognition. For these reasons, Galoob presents its own summary of the pertinent facts and proceedings below.

> controls the changes made by the Game Genie by entering codes provided by the Game Genie Programming Manual and Code Book. The player can also experiment with variations of these codes." (*Lewis Galoob Toys, Inc. v. Nintendo of America, Inc.*, 964 F.2d 965, 967 (9th Cir. 1992), *cert. denied*, 123 L. Ed. 2d 149 (1993) ("*Galoob I*") (Pet. App. A-22))

The Game Genie allows a player to alter the rules of the game, to increase or decrease the difficulty of and modify game play, in ways never before possible. The Game Genie is an ingenious and flexible device, which gives players unparalleled control over the play of their games. The Game Genie was kept from the market for more than a year—including a crucial holiday season—by Nintendo's preliminary injunction.

To assess the impact of the preliminary injunction on Game Genie sales, the District Court was required to compare the state of the market for NES-related products in June 1990 (when Galoob was preliminarily enjoined from the manufacturing, marketing, and sale of the Game Genie) with the market in August of 1991 (when the device finally went on sale). The evidence presented to the trial court demonstrated that, beginning in mid-1991, consumer tastes shifted away from the NES and related products in favor of the 16-bit systems produced by Nintendo and its chief competitor at the time, Sega of America, Inc. GD 144 at 12-13; GD 145 at 13-16. This shift in consumer preferences resulted in a market environment far less hospitable to the Game Genie; and, as the District Court found, this resulted in lost sales in excess of 1.6 million units and lost profits in excess of $15 million. CR 509 ¶6. Because Galoob's damages were limited to the amount of the $15 million security, Galoob was unable to recover from Nintendo the entire amount of its losses suffered as a result of the wrongful injunction.

B. Summary Of Proceedings Below.

In May 1990, after receiving a cease and desist letter from Nintendo, Galoob filed suit for declaratory relief that it did not infringe Nintendo's copyrights. Nintendo responded by filing a completely new lawsuit on June 1, 1990. Nintendo unsuccessfully moved for a temporary restraining order, but received an order to show cause for a hearing on a preliminary injunction, on shortened notice, on June 29, 1990. The District Court granted the preliminary injunction, which was entered on July 2, 1990 and set forth a security requirement of only $100,000.[3] That preliminary injunction—which was wholly rejected after trial and upon appeal to the Ninth Circuit—kept an extremely promising product off the shelves for more than a year, a year which turned out to be the height of the market for the Game Genie.

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[3]Nintendo makes a number of references (Pet. at 5, 17) to a purported "admission" by counsel at the preliminary injunction hearing that Game Genie created a derivative work. These references should be ignored for several reasons. First, it is clear from an examination in the context of the entire record of that hearing that prior counsel did not admit that Game Genie created derivative works. *See* CR 4 at 21-24 (opposition brief arguing that Game Genie did not create derivative works); CR 49 (C-90-1586) at 15:14-25, 16:5-6, 18:12-22, 19:15-21 (numerous statements that Game Genie did not create a derivative work). Second, these references are particularly surprising, since Nintendo properly conceded at the liability trial that these comments had no binding effect. *See* CR 244 at 35; *Thomas v. Sams*, 734 F.2d 185, 192 n.15 (5th Cir. 1984), *cert. denied*, 472 U.S. 1017 (1985); *Harrison Constr. Co. v. Ohio Turnpike Comm'n*, 316 F.2d 174, 177 (6th Cir. 1963). In any event, this has no conceivable relevance to the equitable consideration of the lower courts in connection with the execution of the preliminary injunction security, since any possible impression that Galoob intended to concede the issue of whether Game Genie created derivative works was corrected not only at that hearing, but even more forcefully just a few weeks later in the appeal from the preliminary injunction. Nintendo simply cannot demonstrate (and, indeed, has not even argued) that it reasonably relied in any manner upon such a statement (nor could Nintendo justifiably rely upon the statement of opposing counsel, a clear adversary) in posting security, and it is therefore completely irrelevant.

Faced with economic catastrophe from the preliminary injunction, Galoob, on the next day, July 3, 1990, noticed an expedited interlocutory appeal from the preliminary injunction, and filed a comprehensive opening brief in the Ninth Circuit by August 10—only slightly more than a month after the preliminary injunction had been entered. *At the time that brief was filed on August 10, by new counsel retained by Galoob, Nintendo became fully aware of each and every legal theory that was later litigated by Galoob at the trial on the merits of the copyright infringement claims.* About a month after lodging the appeal, Galoob moved to increase the security for the injunction from the $100,000 originally set by the District Court to $9.1 million covering the anticipated lost profits for 1990. CR 57. The District Court ordered the bond increased to $5 million, its estimate of the profits lost on the 550,000 orders which had already been cancelled. *Id.* at 15, 60. The District Court declined at that time to increase the bond to cover additional lost sales for 1990 or 1991, but invited Galoob to renew its motion in the new year if the injunction was still in effect. *Id.* at 15. *Nintendo chose to post the additional security and maintain the preliminary injunction knowing full well all of Galoob's defenses to its claim of infringement.*[4]

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[4]Nintendo's description of the order of proceedings is more than a little inaccurate; indeed, the most striking misstatement of the proceedings bears some notation here so that the Court will not be confused as to the record. Nintendo states:

> "Despite this rejection [by the Ninth Circuit on the appeal from the preliminary injunction], Galoob did not move in the district court to modify or dissolve the preliminary injunction and thereby obtain the findings of fact essential to its new defenses. Instead, while the action was proceeding toward trial, Galoob simply filed a series of motions to increase the preliminary injunction bond which Nintendo had posted pursuant to Fed. R. Civ. P. 65(c)." (Pet. at 7)

The events in the trial court simply did not happen in the above-quoted sequence. Rather, Galoob moved twice to increase the security *before* the Ninth Circuit ruling on the interlocutory appeal from the preliminary injunction. CR 147 at 2 (September 1990); CR 71 (December 20, 1990,

(continued...)

In December 1990, with a decision still awaited from the Court of Appeals, Galoob renewed its motion to increase the bond to $18-20 million to cover lost sales beyond the initial lost orders. CR 71. That sum covered the estimated lost profits through June 1991, when a decision on the merits in the trial court was expected. *Id.* On January 24, 1991, the Court of Appeals rejected Galoob's interlocutory appeal, finding only that the District Court had not abused its discretion in entering the preliminary injunction, and declining to reach the merits of any of the infringement issues. Pet. App. A-68-74. The District Court granted Galoob's second motion to increase security on March 27, 1991, and ordered Nintendo to increase security to $15 million if it wished to maintain the injunction. CR 147. Voicing some concern in its Order over the lack of judicial precedent to guide trial courts in setting the amount of injunction bonds, the court *sua sponte* certified the issue for immediate appeal pursuant to 28 U.S.C. §1292(b). *Id.* at 10. *Two days later, with trial less than a month away, Nintendo posted the additional security, opting to maintain the preliminary injunction though it was fully aware of all of Galoob's arguments against infringement, and opting not to appeal.* In December 1990, Galoob requested that Nintendo stipulate to modify the injunction to permit it to manufacture (but not sell) Game Genies, in the event that the preliminary injunction was eventually overturned. Galoob expressly acknowledged in making the request that it would bear the financial risk of this strategy. Nintendo refused this entirely reasonable request. Exs. GD 67, 68.

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[4](...continued)
refiled January 15, 1991); *see* CR 89. Moreover, as set forth at length in the text, only three months passed between the Court of Appeals' ruling on the appeal from the preliminary injunction and the *trial* on the merits of the liability case. CR 147, Pet. App. A-68. Indeed, at Galoob's request and over Nintendo's objection, the trial was scheduled and held on an expedited schedule in April 1991, less than a year after Nintendo filed suit. CR 57 at 24, 27; *see* CR 244.

After a two-week trial in late April and early May 1991, on July 12, 1991, the District Court rendered a decision on the merits of Nintendo's copyright claim in favor of Galoob, and vacated the injunction. The District Court also held that injunctive relief would not have been warranted even if there had been infringement, as Nintendo had failed to demonstrate any irreparable harm.[5] CR 289 at 38. A year later, both of the grounds for the holding of noninfringement—that the Game Genie does not create derivative works and that use of the Game Genie is a fair use—were unanimously affirmed by the Court of Appeals and review was denied by this Court. During this period Nintendo filed a motion urging the District Court to exonerate the bond because of Galoob's alleged failure to mitigate. The District Court rejected Nintendo's allegation, ordering execution on the security in "an amount to be determined." CR 317.

Throughout the fall of 1991 the parties conducted extensive discovery. The damages trial (a summary proceeding pursuant to Rule 65.1 of the Federal Rules of Civil Procedure) was held from December 12-19, 1991. Meanwhile, on May 21, 1992, the Court of Appeals affirmed the liability judgment and issued an amended opinion on August 5, 1992. Pet. App. A-20-35. On July 6, 1992, the District Court issued its finding that Galoob had lost 1.6 million unit sales of the Game Genie as a result of the preliminary injunction. CR 509 at 2. Based on its further findings as to net profits per unit, lost interest, and additional costs incurred as a result of the injunction, the District Court found that Galoob had lost *at least* $15 million. CR 509 ¶¶6, 12, 15, 16.[6] Accordingly, the District

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[5]The Court found that, if anything, the Game Genie would *enhance* sales of NES systems and software. CR 289 at 30, 32, 38.

[6]The District Court found it unnecessary to resolve several remaining disputes between the parties concerning the calculation of damages, noting that in any event, Galoob could not recover in excess of the posted security. CR 509, ¶6. Thus, it is clear that Galoob was damaged well in excess of $15 million.

Court entered judgment awarding Galoob the $15 million security. That judgment was affirmed by the Court of Appeals on February 17, 1994 (Pet. App. A-1-18), a timely Petition for Rehearing and Suggestion for Rehearing En Banc was rejected, (Pet. App. A-19) and that judgment is now the subject of this Petition.

REASONS FOR DENYING THE WRIT

Federal Rule of Civil Procedure 65(c) contains a mandatory requirement for posting of security in case of damages sustained by wrongful injunction:

> "**(c) Security.** No restraining order or preliminary injunction *shall* issue except upon the giving of security by the applicant, in such sum as the court deems proper, for the payment of such costs and damages as may be incurred or suffered by any party who is found to have been wrongfully enjoined or restrained. No such security shall be required of the United States or an officer thereof.
>
> "The provisions of Rule 65.1 apply to a surety upon a bond or undertaking under this rule." (Emphasis added)

The security provides a ceiling for recovery of damages by wrongfully enjoined defendants. *Buddy Systems, Inc. v. Exer-Genie*, 545 F.2d 1164, 1168 (9th Cir. 1976), *cert. denied*, 431 U.S. 903 (1977). In determining to execute the injunction security here in favor of Galoob, the Court of Appeals adopted the majority standard of a rebuttable presumption of execution in favor of wrongfully enjoined defendants. Both of the courts below rejected Nintendo's argument that it had demonstrated equitable reasons to avoid enforcement by the wrongfully enjoined and seriously injured Galoob. There is no good reason for this Court to disturb or review that judgment.

The Ninth Circuit followed the majority rule articulated by the District of Columbia in *National Kidney Patients Ass'n*

v. Sullivan, 958 F.2d 1127, 1134 (D.C. Cir. 1992), *cert. denied*, 122 L. Ed. 2d 122 (1993) ("defendant injured by a wrongfully issued preliminary injunction is presumptively entitled to recovery on the injunction bond") and the Seventh Circuit in *Coyne-Delany Co. v. Capital Development Board*, 717 F.2d 385, 392 (7th Cir. 1983) ("principle of preference" in favor of bond enforcement). Contrary to Nintendo, the Ninth Circuit has not articulated a new standard which focuses solely on defendant's good faith, thereby creating a "four-way split" among the Circuits. By its own express holding, the Court of Appeals applied the majority rebuttable presumption standard, and that standard is supported by law and common sense. *See* Section A, *infra*.

In applying the rebuttable presumption standard, the Ninth Circuit did not limit itself to consideration of Galoob's "bad faith," but expressly considered all equitable factors urged upon it by Nintendo. *See* Section B, *infra*. The courts below properly rejected Nintendo's arguments that Galoob "failed to mitigate" its damages, or that Galoob worked a "change of law." To find otherwise, this Court would have to violate the well-established principle that the concurrent factual findings of the District Court and the Court of Appeals should not be disturbed. The Petition provides no reason why this Court should re-examine those factual findings, which in any case were plainly correct and in all events not an abuse of discretion. Moreover, given the record and the findings below, any question regarding the appropriate standard becomes wholly irrelevant to the outcome of this case since Nintendo would not prevail under *any* conceivable standard for execution on the security. *See* Section C, *infra*.

For these reasons, this Court's review of the Ninth Circuit's judgment that Galoob was entitled to execute the security is not only unnecessary, but inappropriate on the record presented in this case. This Court should end this lengthy litigation by denying the Petition.

A. The Rebuttable Presumption Standard Employed By The Ninth Circuit Is Supported By The Text, Legislative History And Policy Of Rule 65(c).

Nintendo's characterization of the holding of the Court of Appeals as tantamount to a strict liability standard is in direct conflict with the express holding in that court's opinion. Nintendo argues that the Ninth Circuit ignored the full range of equitable factors and looked solely to Galoob's good faith, or lack thereof, thereby applying a "narrow and restrictive" standard that should be reviewed by this Court. Nintendo's argument in this regard is completely unsupported by the record. To the contrary, as quoted at length above, the Court of Appeals expressly employed the majority standard of a rebuttable presumption in favor of execution that can be overcome on a showing of equitable reasons against enforcement. It cited the District of Columbia Circuit's opinion in *National Kidney* and the Seventh Circuit's opinion in *Coyne-Delany* as setting forth the "majority" rule it adopted—decisions which Nintendo correctly describes in its Petition as authorizing "consider[ation of] a range of equitable factors." Pet. at 12. Indeed, the Ninth Circuit articulated numerous sound reasons in support of the D.C.-Seventh Circuit standard.

> "We believe this rule is sound. By adhering to this standard, the party enjoined will usually recover damages, thus discouraging parties from requesting injunctions based on tenuous legal grounds. Furthermore, a presumption that damages will be awarded from the bond assures district court judges that defendants will receive compensation for their damages in cases where it is later determined that a party was wrongfully enjoined. Moreover, demands on judicial resources may be relieved to some extent, because a defendant who can recover damages against a preliminary injunction bond will be less likely to file a separate malicious prosecution action. Finally, this standard provides an equitable means

> by which courts can decline to impose damages on the rare party who has lost a case on the merits but nevertheless should not suffer the execution of the preliminary injunction bond." (*Galoob II*, 16 F.3d at 1037 (Pet. App. A-12-13) (citations omitted))

See also Alabama ex rel. Siegelman v. United States EPA, 925 F.2d 385, 391 (11th Cir. 1991) (holding that denial of enforcement of security requires an objectively good reason). In short, the Ninth Circuit explicitly adopted the D.C.-Seventh Circuit standard, and did not create a different standard of its own.[7]

Nintendo does not appear to challenge the Ninth-Seventh-D.C. Circuit standard. A standard permitting any greater discretion in the determination whether to enforce a preliminary injunction security would be inconsistent with the mandatory security requirement of Rule 65(c). Except for the last sentence (not relevant here), Rule 65(c) was adopted verbatim from former 28 U.S.C. §382 (repealed 1948) providing for security for injunctive relief. FED. R. CIV. P. 65(c) advisory committee's note (1937 adoption). Section 382 was originally enacted as part of the Clayton Act and pertained only to antitrust injunctions; later, it was made part of the Judiciary Act and applicable to all preliminary injunctive relief. The history of the provision that later became Section 382 demonstrates that it was adopted in order to *limit* discretion in matters of security for injunctive relief:

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[7]Nintendo's contention that the Court of Appeals refused to consider or correctly apply some of the equitable grounds that it had urged is at most an argument that the court below *misapplied* the very standard that it had adopted, not proof that it (silently) applied a different standard than the one it expressly embraced. In any event, as shown in the next section, Nintendo is wrong about that as well: the Ninth Circuit fully considered and addressed all of Nintendo's equitable arguments—and, for good reason, rejected them.

> "[The section] simply *requires* security for costs and damages in all cases, *leaving it no longer within the discretion of the courts whether any such security or none shall be given.*.
>
> "Prior to the said act of 1872 . . . there appears to have been no legislation on the matter of security in injunction cases; but that security was usually required is a fact well known to the legal profession. It seems clearly just and salutary that the extraordinary writ of injunction should not issue in any case until the party seeking it and for whose benefit it issues has provided the other party with all the protection which security for damages affords.
>
> "It appears by the authorities, both English and American, to have been always within the range of judicial discretion, in the absence of a statute, to waive security, though better practice has been to require security as a condition to issuing restraining orders and injunctions.
>
> "The new section . . . *takes the matter of requiring security out of the category of discretionary matters* . . . ." (H.R. REP. NO. 612, 62d Cong., 2d Sess. 26 (1912)(emphases added))

Thus, Rule 65(c) is mandatory because preliminary injunctive relief is a drastic measure, not a right, and may be obtained without a full and fair opportunity to develop all relevant facts and legal theories. While Congress did not expressly address itself to the standard to be applied to a motion to enforce the mandatory security, it seems obvious that in order to implement properly the policy that it did adopt, that standard must likewise limit courts' discretion to deny enforcement of the security that Rule 65(c) *required* be posted in the first instance. *See National Kidney*, 958 F.2d at 1134 ("[T]his approach is virtually required by the text of Rule 65(c). Although the Rule does not explicitly address the disposition of the bond once the injunction is found

wrongful, payment to the injured defendant seems almost inescapable, since the Rule imposes a requirement of security . . ."). Congress understood the financial consequences to both parties of preliminary injunctive relief, and balanced those risks by requiring security from plaintiffs and limiting their liability in the amount of that security. A standard of limited discretion to deny enforcement of a preliminary injunction security on equitable grounds is therefore the least restrictive standard consistent with the mandatory requirement of Rule 65(c).

There are also serious practical reasons why a standard of limited discretion to deny enforcement on equitable grounds is appropriate. A bond enforcement proceeding should not be converted into a trial on the quality of defendant's presentation at the hearing on the preliminary injunction. Such hearings are typically held on minimum notice, discovery is limited or non-existent, hearing time is limited, and trial courts impose strict page limits on the briefing on such motions. Examination by the courts of the arguments made in defending such motions in determining whether to execute injunction security would result in a wholesale invasion of attorney-client privilege, work product, and would inevitably enmesh the courts in burdensome and unnecessary collateral inquiries. As between the plaintiff which temporarily obtains unwarranted preliminary relief and the defendant which was unable to ferret out all of the flaws in plaintiff's claim for injunctive relief in time to forestall an improvident injunction, Rule 65(c) places responsibility on the plaintiff up to the face amount of the bond.[8]

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[8]Nintendo makes much (Pet. at 4-5, 17) of Galoob's retention of a "well-known intellectual property law firm" to advise it regarding the Game Genie, and Galoob's decision to approach Nintendo to discuss a license in an effort to avoid suit. The fact that Galoob sought and received a legal opinion before deciding to manufacture the Game Genie is unremarkable and demonstrates only Galoob's good faith. Galoob's effort to avoid suit by engaging in early, albeit unsuccessful, discussions

(continued...)

B. The Ninth Circuit Did Not Limit Itself To Consideration Of Galoob's "Bad Faith"; Rather, It Expressly Considered The Equitable Factors Urged Upon It By Nintendo.

Nintendo argues that two equitable factors—"failure to mitigate" and "change of law"—were relevant to the determination of whether the security should have been executed and were not considered by the Ninth Circuit. This argument is unsupported by the record—which clearly reveals that the Ninth Circuit did consider these arguments. As Nintendo advanced its equitable arguments below and in the trial court, however, both of these so-called arguments relied upon the same factual premise: that Galoob's alleged withholding of arguments at the preliminary injunction worked some unfairness to Nintendo. Nintendo argues that Galoob "failed to mitigate" by failing to come back to the District Court a second time with a motion to modify or dissolve the preliminary injunction prior to trial.[9]

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[8](...continued)
with Nintendo is hardly an equitable reason for denying enforcement of the injunction bond.

[9]Nintendo's argument labeled "failure to mitigate" may sound appealing in the abstract but in fact it has absolutely no application to the facts of this case. Failure to mitigate is a doctrine to be considered not upon a liability determination, but later, in the determination of the *amount* of damages:

> "[A] defendant's failure to mitigate damages should not constitute grounds for exercising discretion to deny the defendant recovery of all damages. The court should consider a defendant's failure to mitigate damages when determining how much compensation the defendant should receive for his injuries; the court should allow the defendant the amount normally allowed under the common law doctrine of mitigation of damages." (Note, *Recovery for Wrongful Interlocutory Injunctions Under Rule* 65(c), 99 HARV. L. REV. 828, 845 (1986)(footnote omitted))

Nintendo did argue below that Galoob failed to avoid incurring some portion of its damages by failing to avoid the loss of some number of
(continued...)

In support of its equitable arguments, Nintendo specifically relies here, as it did below, upon the decision in *Page Communications Engineers, Inc. v. Froehlke*, 475 F.2d 994 (D.C. Cir. 1973). In excusing the plaintiff from its security obligation, the court in that case primarily relied upon the failure by the defendant to timely file an important piece of evidence, a fact which Nintendo heavily analogizes here. *Page Communications*, 475 F.2d at 997; Pet. at 14-15, 20. However, as the Ninth Circuit held, no comparable conduct occurred in this case. In *Page Communications*, the defendant had the information later determined important by the court at its disposal and failed to produce it despite the fact that it had agreed to do so in open court. 475 F.2d at 996. Thus, the holding in *Page* was not "[i]rrespective of whether that omission was accidental or intentional" (Pet. at 20); rather, there was clear evidence of intentional misconduct. As the Ninth Circuit explained:

> "*Page Communications* is inapposite. There, the court declined to award damages to an enjoined defendant in a contract action. The defendant earlier agreed to produce 'all "records relating to the evaluation of proposals submitted" by the various offerors, and all "documents setting forth the basis for the award."' Although this language described a particular report the defendant possessed, the defendant intentionally declined to produce the report. In granting the injunction for the plaintiff, the district court believed erroneously it had examined all the relevant evidence. Because the defendant was responsible for the missing evidence, and because the district court would probably not have granted the injunction had it seen the report, the court concluded that in light of

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[9](...continued)
sales of the Game Genie but that argument was rejected by the District Court. CR 485 at 219-20. No question relating to the amount of damages has been raised in the Petition.

these circumstances, it would be inequitable to assess damages against the plaintiff.

"Here, Galoob did not fail to produce evidence. It did not deceive the court. There is no indication in the record that Galoob sandbagged Nintendo into prevailing upon its application for the preliminary injunction, knowing all the while that it could have defeated that application. Those facts are simply not this case. All that appears is that Galoob had additional defenses it asserted at the time of trial, defenses it had not asserted at the preliminary injunction hearing. And while it is true that Galoob persuaded the court on two successive occasions to increase the amount of the bond, thus raising the stakes of the game, it is also true that Nintendo called these raises by putting up additional amounts of the bond. We conclude Galoob's litigation conduct does not preclude it from recovering on the bond." (*Galoob II*, 16 F.3d at 1037-38 (citations omitted) (Pet. App. A-14-15))

Thus, Nintendo's argument that the Ninth Circuit failed to consider the equitable factors urged upon it cannot be sustained. In fact, as is apparent from the opinion, the Court of Appeals clearly considered and rejected the argument that Galoob withheld defenses; it just did not choose to use Nintendo's labels of "failure to mitigate" and "change of law" in its analysis. The fact that the court characterized Nintendo's argument as one regarding Galoob's good faith does not vitiate the court's careful consideration of the *facts* which Nintendo argued equitably entitled it to avoid execution of the security.

C. Nintendo's Argument That Galoob Is Equitably Barred From Enforcing The Bond Because It Did Not Seek Reconsideration Of The Preliminary Injunction Improperly Seeks Review Of The Lower Courts' Exercise Of Discretion And In No Event Raises An Issue Worthy Of Review By This Court.

Nintendo insists that the Court of Appeals misapplied the equitable standard it purported to adopt when it rejected Nintendo's equitable arguments. It argues that Galoob was required to, and did not, seek reconsideration of the preliminary injunction after its new counsel identified defenses not presented to the District Court at the time of the preliminary injunction hearing. In effect, Nintendo claims that a preliminarily enjoined defendant must return to the District Court for reconsideration of that injunction each and every time it develops a new factual or legal defense or face non-enforceability of the injunction bond.

Nintendo's argument raises a highly fact-specific question of equitable balancing. Both the District Court and the Court of Appeals rejected Nintendo's requests for a finding that Galoob's litigation conduct resulted in some unfairness to Nintendo.[10] The rejection of Nintendo's argument that it was equitably entitled to avoid enforcement of the security on this ground was entirely correct, and should not be disturbed by this Court.

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[10]In denying Nintendo's motion for exoneration, the trial court *a fortiori* rejected Nintendo's arguments that it was equitably entitled to avoid enforcement of the security. CR 314; CR 317. This implied finding is entitled to the same deference on appeal as is the express finding of the Court of Appeals in that regard. Moreover, to the extent that the trial court's findings lack specificity on this point, Nintendo bears the burden of that lack of specificity, since it neither proposed more specific findings nor moved to amend the ones that were ultimately adopted, as authorized by Federal Rule of Civil Procedure 52(b). *Lindquist v. Idaho State of Bd. of Corrections*, 776 F.2d 851, 857 (9th Cir. 1985) ("Certainly, a party who does not provide the trial court with suggested amended or alternative findings on the issue to be reviewed on appeal is not in a favorable position to complain about their incompleteness").

Granting certiorari to review the lower courts' determination that Galoob's litigation conduct was not unfair to Nintendo would require disregard of the principle that this Court should not disturb the concurrent findings of the lower courts. *International Brotherhood of Electrical Workers v. Foust*, 442 U.S. 42, 46 n.7 (1979) (finding that conduct at worst amounted to negligence could not be made in derivation of two-court rule); *Graver Tank & Mfg Co. v. Linde Air Prods. Co.*, 336 U.S. 271, 274 (1949), *adhered to in part, rev'd in part on other grounds*, 339 U.S. 605 (1950). There is nothing in the Petition that would warrant a departure from this principle or compel review of a decision that, in the particular facts of this case, Galoob's presentation of its defenses was not inequitable or unfair to Nintendo.

In any event, the issue of whether the courts below correctly applied the Ninth-Seventh-D.C. Circuit standard to the facts of this case is one which must be reviewed under the "abuse of discretion" standard. *See Pierce v. Underwood*, 487 U.S. 552, 558 (1988). The findings below are anything but an abuse of discretion.

In the first place, there simply was no unfairness to Nintendo. The legal defenses upon which Galoob ultimately prevailed at trial and in the Court of Appeals in defeating Nintendo's copyright infringement claim were raised by Galoob and tendered to Nintendo just *six weeks* after entry of the preliminary injunction in a brief seeking reversal of that injunction. Brief of Appellant, No. 90-15936 (9th Cir. August 13, 1990). If Nintendo had second thoughts about the strength of its infringement claim, it could have withdrawn the preliminary injunction or, at the very least, joined in Galoob's request that the Court of Appeals reach those defenses on appeal from the preliminary injunction. Instead, Nintendo persuaded the Court of Appeals that those defenses had not been sufficiently raised before the District Court and that the Court of Appeals should exercise its discretion to refuse to

consider them. As a result, the preliminary injunction remained in force.

More important, it was only *after* Galoob's defenses had been presented (and fully briefed) to the Court of Appeals on August 10, 1990 that Galoob sought increases of the preliminary injunction security. *Id.*; CR 147 at 2. Those motions resulted in two orders increasing the security first to $5 million and then to $15 million. At each of those points in the proceedings, Nintendo could have decided that Galoob's defenses created too great a risk, declined to post the additional security, and pursued its claim for damages. Instead, in each instance it posted the additional bond within two days of the orders, thereby keeping the preliminary injunction in force. There is nothing inequitable about enforcing the $15 million security posted by Nintendo long after it had been presented with a full briefing by Galoob of *all* of its defenses to the infringement claim.[11]

Moreover, it was not possible for Galoob to seek modification or vacation of the injunction, since the Court of Appeals was vested with jurisdiction over the request for preliminary injunctive relief until just a few months prior to trial.[12] Furthermore, Galoob informally requested that

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[11]For this reason, among others, Nintendo's "change of law" argument merits little response. The change of law contemplated by the court in *Coyne-Delany* was a change in the Rule of an intermediate state appellate court relied upon by the trial court in that case in granting the preliminary injunction. 717 F.2d at 392. A drastic change in law by an outside actor is far different from the circumstances presented here, where additional legal theories were developed during the full presentation of the case. There simply is no support for calling changes in a party's advocacy as a case develops and discovery proceeds a change of law sufficient to warrant denial of execution on an injunction security. Indeed, such a rule would severely prejudice defendants' ability to employ the range of defenses available to them and is particularly inappropriate here where Nintendo was always fully aware of the so-called "change of law" in posting its security.

[12]Under Federal Rule of Civil Procedure 62(c),

(continued...)

Nintendo allow it to modify the injunction in order to mitigate the damage that was sure to result, and Nintendo steadfastly refused. *See* Exs. GD-67, 68. In any event, the notion that—as a condition of bond enforcement—the defendant is bound to seek reconsideration of the preliminary injunction whenever it identifies a new factual or legal defense is completely unsupported by any case authority and is preposterous. Such a rule would result in endless motions to modify preliminary injunctions in already overburdened district courts.

The facts of this case provide a good illustration of why such a requirement would be imprudent. In order to enforce the preliminary injunction security here, Nintendo could have had Galoob forego its right to appeal so that the District Court could retain jurisdiction over the preliminary injunction in case Galoob discovered different factual and legal theories which might provide a basis for vacating of the preliminary injunction.[13] There is simply no support

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[12](...continued)

> "the [district] court in its discretion may suspend, modify, restore, or grant an injunction during the pendency of the appeal upon such terms as to bond or otherwise as it considers proper for the security of the rights of the adverse party."

Such action is allowed only to preserve the status quo pending appeal. *McClatchy Newspapers v. Central Valley Typographical Union No. 46*, 686 F.2d 731, 734-35 (9th Cir.), *cert. denied*, 459 U.S. 1071 (1982). In *People ex. rel. Van De Kamp v. Tahoe Regional Planning Agency*, 766 F.2d 1319, 1322, *modified on other grounds*, 775 F.2d 998 (9th Cir. 1985), the court held that the "notice of appeal deprived the district court of jurisdiction to grant the requested modifications" to the preliminary injunction. Here, a motion to modify in the district court based on the new legal defenses certainly would have altered the status quo, and the district court therefore would not have had jurisdiction to entertain such a motion until the Court of Appeals ruled on January 24, 1991. *See also Pyrodyne Corp. v. Pyrotronics Corp.*, 847 F.2d 1398, 1403 (9th Cir.), *cert. denied*, 488 U.S. 968 (1988); *Christian Science Reading Room Jointly Maintained v. City & County of San Francisco*, 784 F.2d 1010, 1017, *modified on other grounds*, 792 F.2d 124 (9th Cir. 1986), *cert. denied*, 479 U.S. 1066 (1987).

[13]Moreover, while it is true that the particular *legal* defenses upon (continued...)

for that proposition; indeed, such a rule would essentially vitiate the right to take an immediate appeal from an order entering a preliminary injunction.

Even if Nintendo would not put Galoob to this Hobbesian choice, its argument that Galoob should have moved to modify in the District Court after the ruling on the interlocutory appeal must also be rejected. Such a motion could not possibly have been brought in this action in the short time between the ruling by the Court of Appeals affirming the preliminary injunction and the trial: indeed, such a motion would as a practical matter require an even earlier trial on the merits of the legal issues. Again, Nintendo would put Galoob to an untenable choice: that of foregoing its expedited trial in return for a motion to modify the preliminary injunction—a motion which could only be viewed by any District Court under similar circumstances as burdensome and abusive.

For all of these reasons, the lower courts' rejection of Nintendo's so-called "equitable factors" is consistent with any standard of discretion applicable to the determination of execution of security by a wrongfully enjoined

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[13](...continued)
which Galoob prevailed on the merits were not presented at the hearing on the preliminary injunction, that is only part of the story. First, Galoob *did* argue at the preliminary injunction hearing that Nintendo had not satisfied the equitable criteria for a preliminary injunction and that there was an adequate remedy at law. CR 49 (C-90-1586) at 29-32. Thereafter, the district court held that even if Nintendo's claim for copyright infringement had been valid, it was not entitled to injunctive relief. CR 289 at 38 ("Assuming infringement, adequate remedies exist at law"; "a permanent injunction in favor of Nintendo would not be an appropriate remedy"). Second, Galoob's legal argument made at the preliminary injunction hearing that Section 117 of the Copyright Act authorized users to make the kind of adaptation possible with Game Genie was expressly not reached or decided at the trial on the merits. Thus, the entire premise underlying Nintendo's argument—that Galoob did not prevail at trial on any issue raised at the time of the preliminary injunction—is plainly incorrect.

defendant.[14] There is no reason for this Court to review the factual determinations made by the courts below.[15]

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[14]Thus, whether other Circuits may permit the trial court greater discretion to deny enforcement of security (*e.g., H&R Block, Inc. v. McCaslin*, 541 F.2d 1098 (5th Cir. 1976), *cert. denied*, 430 U.S. 946 (1977)), or less (*e.g., Blumenthal v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 910 F.2d 1049, 1054 (2d Cir. 1990)) is simply irrelevant here, since on the record of this case, Galoob was entitled to execution under *any* conceivable standard.

[15]Preliminary injunctive relief is a drastic measure which deprives one party of a right without the benefit of a full hearing. In copyright cases preliminary injunctions are especially easy to obtain, because plaintiffs are not put to the burden of demonstrating irreparable harm: rather, as pointed out by Nintendo (Pet. at 25), such harm is normally presumed from a showing of likelihood of injury. While that presumption may be warranted in some instances, here it worked a particular injury, since the District Court ultimately found that there was no irreparable harm. That finding underscores an important point overlooked entirely by Nintendo: *a prevailing copyright plaintiff is entitled to a full panoply of remedies other than injunctive relief, including actual damages and the infringer's profits, or statutory damages, and attorney's fees.*

Furthermore, as both the District of Columbia Circuit and the Ninth Circuit have recognized, there is no cognizable general public interest against enforcement of preliminary injunction security. As noted in *National Kidney*, the mandatory security requirement of Rule 65(c) "expresses a judgment that already subsumes such generic policy considerations as the public interest in providing judicial interpretations of statutes" (958 F.2d at 1135) or, in this case, enforcement of the copyright law.

> "Nintendo's public policy argument is premised on its assertion that public policy favors the issuance of injunctions in intellectual property infringement lawsuits. This assertion is correct only when a *permanent* injunction is sought once infringement has been established. Public policy *does not advocate the liberal issuance of preliminary injunctions in copyright infringement actions.*" (*Galoob II*, 16 F.3d at 1038 (Pet. App. A-15) (citation omitted) (emphasis added))

Nor does public policy dictate a more liberal standard for issuance of preliminary injunctions in copyright cases than is reflected by the lower court's opinion. While there is certainly a strong interest in enforcement of intellectual property rights, there is an equally availing interest in not having the copyright law misused to cause the suppression of new

(continued...)

CONCLUSION

For each of the reasons set forth herein, the Petition should be denied.

DATED: August 17, 1994

Respectfully,

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[15](...continued)
products or ideas. *E.g., Galoob I*, 964 F.2d at 969 (Pet. App. A-27); *New Kids On The Block v. News America Pub., Inc.*, 971 F.2d 302, 308 n.6 (9th Cir. 1992). In order to serve that important policy, compensation must be readily accessible to defendants who are enjoined and found later not to be infringers.

No. 93-2035

(3)

Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1993

NINTENDO OF AMERICA INC.,

Petitioner,

v.

LEWIS GALOOB TOYS, INC.

Respondent.

Petition For A Writ Of Certiorari
To The United States Court Of Appeals
For The Ninth Circuit

REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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No. 93-2035

In The
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NINTENDO OF AMERICA INC.,
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Respondent.

REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

I. THE NINTH CIRCUIT DECISION ACKNOWLEDGED A CONFLICT IN THE CIRCUITS -- AND COMPOUNDED IT

Nintendo's Petition showed that the decision of the Ninth Circuit in the present case further confused a long-standing conflict among the circuits in the application of Federal Rule of Civil Procedure 65(c). Specifically, the Petition pointed out that the Ninth Circuit added a fourth view to what had previously been a three-way split among the circuits. Thus, two circuits had previously held that Rule 65(c) did not limit the broad discretion of the trial court

to deny damage awards to avoid injustice.[1] One, and perhaps a second circuit, had taken a position that would leave no discretion to the trial court, *i.e.*, to make execution on the bond in favor of a successful defendant virtually automatic.[2] A third group, consisting of four circuits, had adopted a position in the middle ground. Those courts held that a range of equitable factors should be considered, but that a bond should be exonerated only when the unsuccessful plaintiff had shown a "good reason" for doing so or had overcome a "rebuttable presumption" in favor of execution.[3]

The Ninth Circuit acknowledged the existence of conflict among the circuits and seemingly endorsed the third view:

> "[W]e join what appears to be the majority and hold there is a rebuttable presumption that a wrongfully enjoined party is entitled to have the bond executed ...." (A-12)

At the same time, however, the Ninth Circuit departed from the majority view by drastically narrowing the factors to be considered in determining whether the presumption in favor of execution had been rebutted. At the hands of the Ninth Circuit, a court's review of equitable factors was essentially limited to consideration of whether a defendant had acted in bad faith, *e.g.*, by deliberately misleading the court or the

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[1] *H&R Block, Inc. v. McCaslin*, 541 F.2d 1098 (5th Cir. 1976), *cert. denied*, 430 U.S. 946 (1977); *State of Kan. ex rel. Stephan v. Adams*, 705 F.2d 1267 (10th Cir. 1983).

[2] *Blumenthal v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 910 F.2d 1049, 1054 (2d Cir. 1990); *American Bible Society v. Blount*, 446 F.2d 588, 595 n.12 (3d Cir. 1971).

[3] *Coyne-Delaney v. Capital Devel. Bd.*, 717 F.2d 385 (7th Cir. 1983); *State of Ala. ex rel. Siegelman v. U.S. E.P.A.*, 925 F.2d 385 (11th Cir. 1991); *Zenith Radio Corp. v. U.S.*, 823 F.2d 518 (Fed. Cir. 1987); *National Kidney Patients Ass'n v. Sullivan*, 958 F.2d 1127 (D.C. Cir. 1992), *cert. denied*, 113 S. Ct. 966 (1993).

plaintiff as to its position. That approach, the Petition pointed out, was so different from the majority view as to constitute a fourth position that, in practical terms, more nearly resembled the minority position favoring automatic execution.[4]

Respondent, for its part, has not denied the existence of a conflict among the circuits that only this Court is in a position to resolve. Rather, Respondent has sought only to lessen the conflict by attempting to portray the decision of the Ninth Circuit as following the majority view. In aid of that approach, Respondent asks this Court to consider only what the Ninth Circuit announced that it was doing and to ignore what in fact the Ninth Circuit did. Only in that way could this Court accept Respondent's claim that: "At bottom, Nintendo seeks review of the Ninth Circuit *application* of the [majority rule] to the particular facts of this case." (emphasis added) Resp. Br. p. 3. That is, of course, not at all what Nintendo seeks. What Nintendo does seek is a resolution of the acknowledged conflict among the circuits. Such a resolution will necessarily entail a review of the novel standard fashioned by the Ninth Circuit and consideration of the unfortunate consequences inherent in that standard. The "particular facts" of this case are most important for the illumination that they provide those issues.

II. CERTIORARI SHOULD BE GRANTED BECAUSE THE CONSTRUCTION OF RULE 65(C) IS OF GREAT IMPORTANCE IN FEDERAL LITIGATION

In the Petition, we pointed out that the grant of a writ of certiorari was supported by the importance of Rule 65(c)

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[4] Significantly the first section of the Respondent's brief in response to the Petition, arguing for "limited discretion" on the part of the trial court, has been recast only slightly from the argument that it presented to the Ninth Circuit in urging adoption of the minority position which permits no exercise of discretion by the trial court. Resp. Br. pp. 12-16.

to federal litigation generally and to copyright litigation in particular. Pet. pp. 23-27. Respondent does not attempt to contravene that proposition.

Rather, Respondent is content to make several collateral observations that are, in the main, correct but in no way diminish the compelling grounds for granting certiorari. Thus, Respondent is correct in noting that a preliminary injunction is, in general, a "drastic measure." To claim further, however, as Respondent does, that some "particular injury" was caused by the injunction here, simply begs the question. *See* Resp. Br. 24. n.15.

Respondent is also correct in asserting that "there is no recognizable general public interest against enforcement of preliminary injunction security." We did not claim the existence of such a general interest in the courts below or in our Petition. We do assert, however, a strong public interest against such enforcement under particular circumstances which make it clear that the defendant's injury resulted in whole, or in principal part, from its own actions or inactions. To permit enforcement under such circumstances is surely to create a chilling effect on plaintiffs -- in copyright cases and elsewhere -- who have meritorious grounds for seeking a preliminary injunction.

Respondent perpetuates the error of the Ninth Circuit, pointed out in the Petition, by asserting that there are no public policy concerns favoring the issuance of a preliminary injunction in copyright cases. *Id.* The existence of such concerns, however, is clearly evidenced by the rule (ignored by the Ninth Circuit but acknowledged by Petitioner) that where a preliminary injunction is sought, the existence of irreparable injury will be assumed upon a showing of infringement. It should be further noted that the availability, noted by Respondent, of a "full panoply of remedies other than injunctive relief" *Id.*, provides little comfort where the infringer is an individual or entity whose financial condition

is questionable.

There is undoubtedly an interest, as Respondent suggests, "in not having the copyright law misused to cause the suppression of new products or ideas." *Id.* That interest, however, can be fully vindicated by the approach to Rule 65(c) followed in the Seventh, Eleventh, Federal and District of Columbia Circuits.[5] It surely does not need the "protection" provided by the Ninth Circuit's distorted version of that approach.

Finally, there is an undisputed element of public interest that requires brief emphasis: an interest in clarity and predictability of legal processes. To serve that interest, we urge this Court to resolve the acknowledged confusion and conflict among the circuits in applying of Rule 65(c). This case, we submit, presents a highly appropriate occasion to do so.

III. THE NINTH CIRCUIT DID NOT CONSIDER A FULL RANGE OF EQUITABLE FACTORS AS MANDATED BY THE MAJORITY RULE

A. The Ninth Circuit Misinterpreted The Principal Authority On Which It Relied And Considered Only The Issue of Respondent's Good Faith

Respondent's attempt to defend the decision of the Ninth Circuit rests upon two basic underpinnings: (1) a view of *Page Communications Engineers, Inc. v. Froehlke*, 475 F.2d 994 (D.C. Cir. 1973), which simply echoes the misunderstanding of that case by the Ninth Circuit; and (2) a misinterpretation of the Ninth Circuit's decision.

With respect to *Page Communications*, Respondent

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[5] *See* cases cited *supra* note 3.

joins the Ninth Circuit in claiming that the decision turned on a finding of "intentional misconduct" on the part of the defendant. In fact, however, as our Petition pointed out, the court in *Page Communications* made no such finding. On the contrary, what was crucial was the fact that, in granting an injunction, the court did not have the benefit of a material document in the possession of the defendant. So here, the District Court did not have the benefit of the legal defenses which Respondent declined to present to it for 10 months. Bad faith or not, that was a clear failure by Respondent to mitigate its damages. If the court had concluded - in *Page Communications* or in the present case -that the defendant had acted in bad faith, such a finding would have been dispositive in requiring an exoneration of the bond. On the other hand, as pointed out in our Petition, a finding of good faith should mark the beginning of the court's inquiry and not the end.

Having vigorously endorsed the Ninth Circuit's view of *Page Communications* as a case of "intentional misconduct," Respondent pivots neatly and heads in the opposite direction. Thus, despite the preoccupation of the Ninth Circuit with intentional misconduct -- or the lack thereof -- Respondent argues that the Ninth Circuit did not limit itself to that issue but also considered the other factors raised by Nintendo below and before this Court. Suffice it to say, however, there is not a wisp of evidence in the decision of the Ninth Circuit reflecting, let alone establishing, such consideration.[6]

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[6] Respondent also presents by way of footnote, still another alternative argument, *i.e.*, that failure to mitigate "has absolutely no application to the facts of this case." Resp. Br. 16, n.9. In this connection, Respondent notes that a failure to mitigate is not relevant to liability but only to the amount of damages and then makes the extraordinary assertion "[n]o question relating to the amount of damages has been raised in the Petition" *Id.* In fact, the entire Petition is addressed to the amount of damages – which may be as high as $15 million or as low as zero. Thus, Respondent has acknowledged that its new defenses were disclosed only six weeks after the preliminary injunction was issued. The record

What Respondent really claims, it turns out, is that the Ninth Circuit considered the "facts" relied upon by Nintendo and disregarded only what Respondent describes as the "labels" applied to those facts by Nintendo. Resp. Br. p. 18. Respondent, however, cannot succeed in denigrating, as mere labels, its failure to mitigate its damage and the metamorphosis of its legal position after a preliminary injunction had been granted. Under a proper analysis, such conduct requires close scrutiny -- not merely to determine whether the defendant had acted in bad faith but to determine whether, in light of such conduct, justice requires that the damages imposed upon the plaintiff be reduced or eliminated altogether. As the court held in *Page Communications*:

> Although Rule 65(c) required a bond here, it does not follow that the District Court was bound to award damages on the bond, without considering the equities of the case. The Rule did not make judgment on the bond automatic, upon a showing of damage. On the contrary, the court in considering the matter of damages was exercising its equity powers, and was bound to effect justice between the parties, avoiding any result that would be inequitable or oppressive for either party. The Rule was not intended to negate the court's duty in this regard. 475 F.2d at 997.

The failure of the Ninth Circuit to apply that standard, cannot be disguised, sanctioned or ignored. Consideration of the "facts" is hardly sufficient, or even meaningful, when the analytical framework of the court is grossly distorted.

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does not establish, and Respondent makes no claim, that Respondent would have sustained any damages as a result of an injunction in effect during only that brief period. The Petition, however, recognized that the failure to mitigate could possibly be found to have occurred at a later date. Pet. p. 21, 22. In that event, the amount of damages would be reduced, but not to zero.

B. The Facts Of This Case Support An Exoneration Of The Bond.

This Court may rule that, as a matter of law, the bond in this case should be exonerated as a matter of law. Alternatively, the case may be remanded to the lower courts for consideration of the facts under a proper standard. The latter course would avoid any involvement by this Court in what Respondent has characterized as a "highly fact-specific question of equitable balancing." Resp. Br. p. 19.

It should be emphasized, however, that the undisputed facts of record clearly support an exoneration. Respondent's failure to mitigate its damage stands undenied and unjustified. Respondent's attempts to explain away its conduct are without merit.

Respondent's principal argument is that its new defenses, on which it ultimately prevailed, were disclosed to Petitioner by Respondent's brief to the Ninth Circuit filed on August 10, 1990. Thus, in Respondent's view, Petitioner could have evaluated the defenses and made its own motion to dissolve the preliminary injunction. That argument stands the concept of mitigation on its head. It suggests that a party may escape its duty to mitigate merely by arguing that the other party should have anticipated the ultimate outcome and ceased its damage-causing conduct. Such an exception, of course would virtually swallow whole any duty to mitigate. Respondent has cited no authority to support such an exception and we are aware of none. Clearly, the responsibility to seek a modification or dissolution of the injunction lay with Respondent.[7]

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[7] In the Petition, we pointed out that, during the period from the granting of the injunction to trial, Respondent did not seek to modify or dissolve the injunction but, rather, made a series of motions to increase the amount of the bond. Respondent does not and cannot deny that fact. Rather, Respondent purports to find some significance in the fact that its motions to increase the bond

Alternatively, Respondent argues that petitioner could have joined with it in urging the Ninth Circuit to consider its new defenses. That argument, however, ignores the fact, emphasized by the Ninth Circuit, that such a course would have deprived Petitioner of the opportunity to develop a factual record in response to those defenses in the District Court. (A-72) Again, the responsibility for having proceeded with a premature appeal lay with Respondent and cannot now be shifted to Petitioner.

Finally, Respondent argues that the Petitioner's position, if applied in this case, would have had the following consequence:

> In order to enforce the preliminary injunction security here, Nintendo could have had Galoob forego [sic] its right to appeal so that the District Court could retain jurisdiction over the preliminary injunction in case Galoob discovered different factual and legal theories which might provide a basis for vacating of the preliminary injunction. Resp. Br. p. 22.

That dire scenario simply bears no relation to reality. Respondent need not have forgone its appeal but merely deferred it long enough for Respondent to have presented to the District Court (giving Petitioner an opportunity to respond) the very defenses that Respondent had already identified, that it urged upon the Ninth Circuit, and that were

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were made prior to the decision by the Ninth Circuit. Resp. Br. p 7, n.3. While that is correct, the salient point is that Respondent made no attempt in the District Court - either before or after the Ninth Circuit decision - to seek relief on the basis of its new defenses. Moreover, we note, the final increase in the bond was not approved by the District Court until March 27, 1994, more than two months after the Ninth Circuit decision.

the basis of its ultimate success.[8]

In short, Respondent has offered no credible explanation for its failure to mitigate its damages by promptly seeking a dissolution of the preliminary injunction on the basis of its new defenses. That failure requires an exoneration of the bond or, at a minimum, a remand to the lower courts.

CONCLUSION

For the foregoing reasons, and the reasons set forth in the Petition, the petition for a writ of certiorari should be granted.

Dated: August 26, 1994

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[8] Respondent has noted statements in the decision of the District Court that "Assuming infringement, adequate remedies exist at law;" and "a permanent injunction in favor of Nintendo would not be an appropriate remedy." Resp. Br. 23 n. 13. However, these conclusory dicta by the District Court were not adopted by the Ninth Circuit and were wrong as a matter of law. See, *e.g.*, *Universal City Studios Inc. v. Sony Corp. of America*, 659 F.2d 963, 976 (other Cir. 1981), *rev'd on other grounds*, 464 U.S. 417 (1984). Further, Respondent has acknowledged that the legal arguments that it presented at the preliminary injunction hearing were not reached or decided at the trial on the merits. *Id.* Accordingly, the judgment against Petitioner rests solely upon arguments not presented at the preliminary injunction hearing – or on any subsequent motion to dissolve the injunction.